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CONSUMER RAIL EQUITY ACT

ORIGINAL

HEARING

BEFORE THE

SUBCOMMITTEE ON
SURFACE TRANSPORTATION

OF THE

COMMITTEE ON COMMERCE,
SCIENCE, AND TRANSPORTATION
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 477

TO ENHANCE RAIL COMPETITION AND TO ENSURE REASONABLE RAIL RATES WHERE THERE IS AN ABSENCE OF EFFECTIVE COMPETITION AND OTHER LEGISLATIVE PROPOSALS TO AMEND THE STAGGERS RAIL ACT

FEBRUARY 21, 1986

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CONSUMER RAIL EQUITY ACT

FRIDAY, FEBRUARY 21, 1986

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE,
AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 253, Russell Senate Office Building, Hon. Bob Packwood (chairman of the subcommittee) presiding.

Staff members assigned to this hearing: Pamela Garvie, staff counsel and Linda Morgan, minority staff counsel.

OPENING STATEMENT BY SENATOR PACKWOOD

Senator PACKWOOD. The hearing will come to order, please.

This hearing is one involving our oversight on the Staggers Act. We had two last November. We are having one today. My hunch is that we will have some others in the future. There have been complaints raised about some of the activities of the railroads under the act. There have been defenses given.

There has been some criticism of the Interstate Commerce Commission and some defense has been given. As most of the members of this committee know, and I think many in the audience, I think on balance, the Staggers Act has not worked out badly.

I can attest to a particular situation where we had a tremendous dispute in Oregon between some small shippers and the Southern Pacific that has worked out satisfactorily.

I would like to read a letter from the representative of the Siskiyou Shippers, as they are called. This is a group of small timber mills that, under the Staggers Act, banded together to contract with the Southern Pacific but they were having some difficulty starting. They came to see me, and I talked with the Southern Pacific, got them to sit down and here is the result in a letter from Mr. Mike Burrill:

> On November 4, 1985, I testified before the Surface Transportation Subcommittee as it was conducting its oversight hearings on the Staggers Act. At that hearing I was representing the position of the majority of the small and medium-sized shippers of the wood product industry located in the Northwest.
>
> At that time I expressed a great deal of concern with contract disclosure and the impossible situation that confronts us due to our small size.
>
> Upon returning home, I made contact with the Southern Pacific Railroad to explain our position again and to try to solve our problem. We were still of the opinion that Southern Pacific was writing contracts. We were assured by Southern Pacific that they had done away with all contracts for lumber and plywood and upon further investigation, we believe that no contracts are presently in existence.

> Senator Packwood met with respresentatives from Southern Pacific and Siskiyou Shippers Association on January 14, 1986. As of that date, we are in agreement, at least for the present, that our initial problems have been solved.
>
> It must be noted that even with our problems being solved, it does not help those shippers on other railroads. Problems still exist and the plight of the captive shipper is still very real. I would urge that as you debate the issue on the Staggers Act, please keep in mind the small captive shippers who do not have the alternatives enjoyed by our larger competitors.
>
> Those of us who belong to the Siskiyou Shippers Association wish to thank Senator Packwood, along with Southern Pacific and their representative, Jack Edwards, for the efforts of bringing about the changes necessary to solve our initial problems.

Now, that is simply a small example of something that we were able to work out through negotiation to the satisfaction of the small- and medium-sized lumber mills in the area, and it has been worked out to the mutual benefit of all of them.

So this act can work and problems that do appear insurmountable can be surmounted if you have a willing railroad—and Southern Pacific was willing in this case—and shippers who are sufficiently openminded to sit down and attempt to negotiate something that they did not understand they could negotiate or do until the Staggers Act passed, and they can make it work.

It may not work at all times. It may only solve initial problems, and other problems will come up. But there is extraordinary latitude in that act for the railroads and the shippers to do all kinds of things without the involvement of the Interstate Commerce Commission, without the amendment of the Staggers Act, to the mutual satisfaction of all parties concerned.

Senator Rockefeller.

OPENING STATEMENT BY SENATOR ROCKEFELLER

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Clearly, I am very appreciative of your willingness to conduct this hearing. The Consumer Rail Equity Act makes necessary midcourse corrections, in my judgment, in the implementation of the Staggers Rail Act. It is absolutely critical to the future of the coal industry in my State.

Likewise, it will have, in my judgment, a profound and positive impact on other bulk commodity shippers, including grain and lumber.

I am a cosponsor of S. 477, the legislation before us. For years I have been convinced that the ICC's implementation of the Staggers Act has fundamentally and drastically departed from the original congressional intent. The underlying philosophy and intent of the Staggers Act remain sound, but its spirit and intent have been undermined.

A deregulated rail industry has brought the railroads back to a robust economic condition, and that result is in the Nation's collective interest. But the ICC's failure to check the monopoly power of the railroads and captive shipper cases is not in the Nation's interest.

Furthermore, it is not in the Nation's interest for Congress to stand idle while the ICC continues to weave a bizarre web of regulatory interpretations, always for the benefit of the railroads, never for the benefit of the shipper.

Mr. Chairman, I supported and cosponsored S. 477 even before our oversight hearings last November, but three recent circumstances have put this issue further at the top of my list of legislative priorities and bolstered my resolve to make appropriate changes to the Staggers Act.

First, I have just come back from a visit to Japan and Korea with the chairman of this committee, of the full committee. I had an opportunity to talk with Japanese energy officials and Korean energy officials. I learned first-hand how imperiled our already dwindling coal trade and those countries has become. The facts speak for themselves with respect to Japan.

When the Staggers Act was passed, we exported almost 26 million tons of coal to Japan. Unless we take immediate steps to reduce the rail transportation costs of our coal, we are likely to lose the remaining 10 to 12 million tons of that export trade.

Official after official, company industrial person after person told us that the basic thing we could do in this country to make ourselves more competitive is to reduce the cost of transporting our coal by rail. They said at the mine mouth we are competitive, but on the rail—from the mine mouth to the port, we lose our competitive edge.

Second, Mr. Chairman, with all West Virginians, I was appalled by the announcement by Jacksonville Electric of its plan to import 800,000 tons of Colombian coal. This adds yet another utility to the list of those who are looking at foreign sources of supply, in part because of excessive rail rates.

It also amazes me to think that Virginia Power, in the heart of coal country, would test-burn and think about large purchases of Colombian coal. For the United States to be importing coal is about as crazy as if Saudi Arabia were to import oil.

Changing the Staggers Act, as we propose, would go a long way in my judgment toward stopping imported coal at the border.

Third, we have just been through Senate debate on the sale of Conrail. The Senate's decision to unload that railroad to the Norfolk Southern Corp., if adopted by the Congress, would make shippers more captive, extend greater monopoly control to fewer railroads, and make it harder for coal shippers to get a fair deal on rates.

In my view, it opens the door to further importation of Colombian coal and Canadian electric power. If we sell Conrail to another railroad, which at least the Senate has decided to do, I think it would be even more imperative that we undo the regulatory morass that the ICC has created.

Mr. Chairman, I would say finally, I do not know what the reaction of the committee will be to the President's recommendation to abolish the ICC. With all due respect to the chairman who is with us today, they have brought this on themselves, but whether the implementation of the Staggers Act is handled by them or by some other successor agency, it is time to restore the original congressional intent.

While this legislation seeks a basic fairness and an appropriate balancing of shipper and railroad interests before the Interstate Commerce Commission, I think it also seeks basic fairness for coal shippers and coal miners, basic fairness for utilities and electric ratepayers, basic fairness for grain and timber shippers and their customers.

Mr. Chairman, the coal industry in my State is under intense competitive pressures and industry is responding, adjusting, modernizing, trying to compete. The improvement in labor management relations in the coal fields is the untold story of industry of the last 10 years.

There has been extensive mechanization in the mines, as back in the fifties, at great cost and with loss of jobs because it is necessary to compete. We are willing to do that. Everybody involved in the coal industry is doing his share to meet the competitive challenge except the railroads and ICC. They are getting away with murder, and it is time that it is stopped.

I am hopeful that we will complete our hearings on this bill in the near future and that we will move it to markup. The Staggers Act, Mr. Chairman, saved the railroads. Now it is time we begin saving all of the industries which depend on the railroads.

I thank the Chair.

Senator PACKWOOD. Senator Long.

OPENING STATEMENT BY SENATOR LONG

Senator LONG. Mr. Chairman, I wish to thank you—you, Chairman Packwood, and you, Chairman Danforth—for scheduling these hearings today. I am one of the original sponsors of S. 477. Last November this subcommittee held 2 days of oversight hearings on ICC's implementation of the Staggers Rail Act.

We had a diverse group of witnesses and, almost without exception, they were deeply concerned with the ICC's treatment of captive shippers. This testimony came from those who are concerned about the reasonableness of rail rates. It also came from those who seek to preserve competition through joint rates and reciprocal switching agreements. Witnesses represented utitilities, manufacturers, consumer groups and midwest grain and timber shippers.

Many of these witnesses made the point that the ICC represents their only source of protection from market power abuse by the railroads. Competitive alternatives are not available.

They also made it clear that the ICC has imposed onerous burdens and procedures on captive shippers that make it almost impossible to secure a fair hearing or any reasonable relief—in fact, in most cases, no relief at all.

I would like to ask permission to include in the record some brief excerpts from testimony and statements submitted to the committee last November.[1]

Senator PACKWOOD. Without objection.

Senator LONG. These comments clearly establish the need for Congress to take action in light of the ICC's record.

May I say, Mr. Chairman, in addition to that, that I for one cannot put all the blame on the ICC as some might seek to do. I was a sponsor of the amendment, the so-called Long-Cannon amendment that sought to provide relief in these type situations. The amendment was a compromise. The railroad people were resentful that Senator Cannon went along with that amendment at all.

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[1] See p. 152.

People on my side felt that the amendment was far from adequate, and I fear that the way it worked out is that the amendment has proved to be a dead letter.

Now, that is part of the Staggers Act. I just regret—from my point of view, it was supposed to protect against the kind of thing these people are complaining about. I regret to say as a sponsor of that portion of the Staggers Act that it achieved zero in my opinion. And I was a sponsor and promoter of it.

I was chairman of the Transportation Subcommittee at that time as I recall, and Senator Cannon was chairman of the full committee. This matter was handled by the full committee. And as one who once was chairman of the Monopoly Subcommittee of the Small Business Committee, I do not think I have ever proposed something that permitted the railroads to victimize customers the way that we have had it testified to us, time and again.

But I fear the inadequacy of the amendment which, from my point of view, was all we could get—it was either that or nothing. If we had tried to get more than that, we would have failed. And I regret to say that we probably would have been better off even not to do that because it proved to be a totally illusory piece of legislation, giving people hope where no relief was in fact available.

I hope and believe that today's hearing will show that we can change the ICC's approach to the captive shipper protection without doing violence to the Staggers Act. That is what I thought we were doing, by the way, when we passed the Staggers Act.

The legislation that has been proposed does not seek to impose new or needless regulations or jeopardize the real gains which railroads have made in the past 5 years.

Mr. Chairman, I know there are a large number of witnesses who would like to testify today but cannot because of time considerations. I have received a number of letters from shippers who would like to testify, and they were included in what I asked to be included in the record.

Senator **PACKWOOD**. Senator Ford.

Senator **FORD**. Mr. Chairman, I worked awfully hard on my statement this morning, and when I came to the office to pick it up, I could not find it anywhere.

And after Senator Rockefeller got through with his statement, I knew who found it.

So I wanted to associate myself with his remarks.

Senator **PACKWOOD**. Senator Danforth.

The **CHAIRMAN**. I have no opening statement.

Senator **PACKWOOD**. Senator Gorton.

Senator **GORTON**. No statement, Mr. Chairman.

Senator **PACKWOOD**. Senator Gore.

OPENING STATEMENT BY SENATOR GORE

Senator **GORE**. Mr. Chairman, I want to thank you for holding this hearing. I know this is not an easy issue to explore—rail regulation questions are complicated, there are many players involved, and the role of the Congress is not always readily apparent.

But the stakes here are huge. The Staggers Act was one of the most sweeping redirections in the involvement of Government in our economy, and in some respects the change was positive. There is no question that our country's railroads are stronger financially, and in a better position to compete with other carriers for freight business.

But, however beneficial the Staggers Act has been for the major railroads, there is a gnawing question that remains: What has this windfall for the railroads cost our country in other terms? We've seen wholesale abandonment proceedings along less populated routes, lost jobs in communities that are already on the ropes, enormous increases in electric rates—billions each year—dumped on consumers captive to coal movements.

Of course, the railroads are hardly to blame for taking advantage of a great competitive advantage in pricing under deregulation. The real issue before us is this:

Given the track record since enactment of Staggers, should we revisit the issue, fine tune this law to reflect that record, and do whatever it takes to restore fairness and stability for shippers and the communities they serve?

Or, at a very minimum, shouldn't we find out why the ICC has failed to perform even a perfunctory role in protecting captive shippers and communities and shippers faced with aggressive abandonment practices?

I am hopeful that this hearing, and those to follow, will go a long way toward resolving these issues. I am a sponsor of S. 477, the Consumer Rail Equity Act now before the committee. I am aware that the bill is very controversial—if you are a captive shipper, a community faced with abandonment, a utility trying to cope with skyrocketing coal rate rates—you are for this bill.

On the other hand, if you are a major railroad that has taken advantage of sweeping deregulation—unregulated rate increases, widespread abandonments, and so on—to produce enormous profits from those new policies, you are certainly against the bill.

There are other issues I hope to explore with the ICC commissioners, such as the deplorable foot dragging on the boxcar rulemaking process. I know this particular matter is not specifically addressed in the Consumer Rail Equity Act, but it is nevertheless timely, relevant to rail deregulation, and deserves attention during this hearing.

The continuing delay by the Commission is resolving this problem clearly endangers our country's shortline railroads. Without enactment of the fair compromise agreement proposed last November, hundreds of these smaller operations will face economic chaos and vulnerability at the hands of the enormously powerful major carriers.

In Tennessee, for example, the Corinth & Counts Railroad is a 26-mile shortline serving 12 customers, who provide thousands of jobs in the Midsouth area. Corinth & Counts has made a costly effort to upgrade its boxcar fleet to continue to serve those shippers, but its profit margin on that fleet is marginal at best. Without mandatory interchange requirements to allow Corinth & Counts' boxcars access to connecting carriers, and reasonable compensation for the carriage of those cars by other carriers, that shortline could be faced with extinction.

It is one thing to allow the major railroads a competitive advantage. It is clearly another to allow them to overwhelm small shortline operations by exercising inordinate marketplace clout under deregulation.

Mr. Chairman, I believe the ICC has been derelict in not moving toward a decision on this issue before now. I believe this committee should send Commissioner Gradison and her colleagues the strongest possible message that further delay is completely unacceptable.

I look forward to working with you, Mr. Chairman, and the entire committee as we look for answers to this and the many other serious questions that have arisen as a result of this administration's zeal toward total deregulation in the rail freight industry.

Thank you.

Senator **Packwood**. Senator Pressler.

OPENING STATEMENT BY SENATOR PRESSLER

Senator **Pressler**. Let me first congratulate the chairman for holding this hearing this morning. As a member who has not made up his mind on the issue, I am looking forward to an enlightening hearing.

Consideration of the Consumer Rail Equity Act is indeed an important issue. Its opponents say that it would roll back the Staggers Act and, to a large degree, reregulate the industry. Its supporters say it only redefines what the ICC's original interpretation of the act should have been and claim to support the thrust of Staggers.

As one who originally voted against Staggers, I find myself in something of a peculiar situation today. I agree that it would be a mistake to go back to pre-Staggers regulation standards. Most of the harm that has been done to the rural States as a result of rail deregulation has already taken place, I hope. The thousands of miles of abandoned track in rural States would not be brought back to life if we were to roll back the clock now. Indeed, there is reason for hope in rural States with the recent increase of shortline and regional railroads. We are today undergoing that process in South Dakota as well as many other parts of the Midwest. With entrepreneurs like Jerry Ross of Dakota Rail in Milbank, SD, who is in the hearing room this morning, there is hope for us in the Midwest. Jerry has worked miracles in our State and we are fortunate to have him.

There were many good aspects of Staggers, and it has been very effective in reviving the rail industry. Indeed, today I would oppose an effort to repeal Staggers. But just as certain as I am that it would be a mistake today to return to a heavily regulated industry, I am afraid that is exactly where we are headed. I am not convinced that this legislation is the vehicle, but I am afraid we will be back in the regulating business very soon if current trends continue.

Since enactment of Staggers, the number of large railroads has continued to decline. Mergers proliferate. The big are getting bigger, and the small are getting worried. As the giants increase in size and decrease in number, a handful of railroads are controlling a great majority of the rail traffic. True, there are efficiencies to be realized through mergers. But they will not always be passed along if we allow competition to be eliminated along the way. To me, this rapidly increasing consolidation is a very worrisome trend.

The proposed sale of Conrail to Norfolk Southern is a good example. Today, Conrail and Norfolk Southern compete for east coast traffic. Merged they would control it. The combination would create the single largest rail monopoly in our country's history, and I do not like it one bit because once again it spells big trouble for the Midwest. And now is not a time for trouble. We have lived through the total collapse of the Rock Island. We have lived through the bankruptcy of the Milwaukee. We have lived through the bad aspects of Staggers. The picture is not all that rosy today. Add a Conrail/Norfolk Southern merger on top of all that we have been through recently, and the Federal Government could have a new ward to care for.

The reason that this type of merger will do such violence to the Midwest is that a merger system will control virtually all rail traffic originating and terminating throughout the east coast. Through its control of that traffic, rail gateways, and joint rates, Norfolk Southern will be able to divert transcontinental traffic from the efficient Midwest route to its more circuitous southern route. This will result in huge traffic diversions for Midwest carriers. The Chicago & North Western estimates diversions of $60 million; ICC estimates $32.3 million; and Grand Trunk estimates $31.4 million.

I am pleased that the administration has finally acknowledged the problem, but I am also disappointed that it refuses to agree to a solution which provides adequate relief for Midwestern shippers and railroads. We have worked for countless hours in an attempt to devise a solution to this very fundamental problem. As it turns out, the only viable solution that has been agreeable requires a substantial reregulation of the industry. Parties on all sides of the issue acknowledge that fact. If this problem is to be solved in the House, it appears that some sort of reregulation will be necessary unless they opt for a stand alone Conrail solution. But if it is not addressed in the Conrail bill itself, I predict that we will be back here within 2 years of enactment—deeply involved in a serious effort to reregulate the rail industry. That is not a pleasant thought.

I raise this subject within this context because of its relation to the Staggers Act and the direction of this country's transportation policy. If we are not careful we will be back in the railroad regulating business if not through the Consumer Rail Equity Act legislation we are considering today, then through a revisitation of Conrail. I for one do not want to get back in that business.

I also have some concerns regarding the boxcar hire proceeding before the ICC. I will have a statement and be submitting some questions for the record on that issue later.

With that, Mr. Chairman, I will close so we can proceed with consideration of the issue at hand.

[The bill follows:]

99th CONGRESS
1st Session

S. 477

To enhance rail competition and to ensure reasonable rail rates where there is an absence of effective competition.

IN THE SENATE OF THE UNITED STATES

February 20 (legislative day, February 18), 1985

Mr. Andrews (for himself, Mr. Long, Mr. Stevens, Mr. Ford, Mr. DeConcini, Mr. Johnston, Mr. Melcher, Mr. Gore, and Mr. Bentsen) introduced the following bill; which was read twice and referred to the Committee on Commerce, Science, and Transportation

---

A BILL

To enhance rail competition and to ensure reasonable rail rates where there is an absence of effective competition.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Consumer Rail Equity Act".

SEC. 2. PURPOSE.

The purpose of this Act is to clarify and reaffirm the intent of the Congress that the Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of

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1980 be interpreted and implemented in a manner which will—

(1) revitalize the national railroad system,

(2) ensure adequate service to the public,

(3) provide an opportunity for the nation's railroads to earn adequate revenues under honest, economical and efficient management, and

(4) enhance the availability of competitive alternatives,

under a balanced approach that encourages and promotes intramodal competition while providing adequate protection for persons served by market dominant rail carriers.

SEC. 3. MARKET DOMINANCE.

(a) Definition of Market Dominance.—Section 10709(a) of title 49, United States Code, is amended by inserting "(1)" after "(a)" and by adding at the end thereof the following: "In determining the existence or absence of effective competition, the Commission shall consider only transportation competition for movement of the same commodity from the same point of origin to the same destination.

"(2) If a person challenging a rate demonstrates, with respect to the transportation to which the rate applies, that alternative noncircuitous rail service is not available from the same point of origin to the same destination (excluding transportation by or over the lines of any rail carrier that partici-

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pates in the transportation to which the rate applies), the rail carrier(s) charging or proposing such rate shall be presumed to have market dominance over the transportation to which the challenged rate applies unless the rail carrier(s) charging or proposing the rate show(s) and the Commission finds that effective competition exists from other carriers or modes of transportation for the transportation to which the rate applies.".

(b) PROCEDURE.—(1) Section 10709(b) of such title is amended by striking out "under section 10707 of this title to investigate" and inserting in lieu thereof "initiated to consider".

(2) The first sentence of section 10709(c) is amended by striking out "may then determine" and inserting in lieu thereof "shall determine".

SEC. 4. RATE REASONABLENESS.

(a) BURDEN OF PROOF.—Section 10701a(b)(2) is amended to read as follows:

"(2) In any proceeding to determine the reasonableness of a rate described in paragraph (1) of this subsection, the rail carrier establishing the challenged rate shall have the burden of proving that such rate is reasonable.".

(b) DIFFERENTIAL RATES.—Section 10701a(b) is further amended by adding at the end thereof the following new paragraph:

"(4) The Commission may not determine a rate to be reasonable for purposes of this section if such rate exceeds the fully allocated cost of the transportation to which the rate applies, unless the Commission finds, with respect to the challenged rate, that the differential in excess of fully allocated cost is not greater than that which would result were the rail carrier, to the extent practicable, to equitably allocate the burden of producing revenues required to achieve or maintain revenue adequacy—

"(A) to the challenged rate, and

"(B) to all other rates which yield a revenue-variable cost percentage in excess of 180 percent (or such lower percentage as may be in effect under section 10709(d)(2)).".

(c) DETERMINATION PROCESS.—(1) Section 10701a(b)(3) is amended by inserting ", including the policy" after "title" and by inserting "be allowed to" before "earn".

(2) Section 10701a(b) (as amended by subsection (b)) is further amended by adding at the end thereof the following new paragraph:

"(5) In determining whether a rate described in paragraph (1) is reasonable, the Commission shall make specific findings with respect to—

"(A) the consistency of such rate (and such determination) with (i) each element of the rail transportation policy in section 10101a at issue in the proceeding, and (ii) the factors described in section 10707a(e)(2)(C); and

"(B) where applicable, the factors described in paragraph (4).".

(d) AMENDMENTS TO RAIL TRANSPORTATION POLICY.—(1) Section 10101a of such title is amended by striking out "and the demand for services" in paragraph (1); by inserting ", consistent with paragraph (6)," after "minimize" in paragraph (2); and by amending paragraph (6) to read as follows:

"(6) to maintain reasonable rates where there is an absence of effective competition;".

(2) Paragraph (15) of such section is amended to read as follows:

"(15) to encourage and promote competitive transportation rates for both domestic energy supplies and domestically produced agricultural commodities in order to increase their competitive position in both import and export markets.".

(e) ACCOUNTING; INFLATION ADJUSTMENTS.—(1) Section 10707a(a)(2)(B) of such title is amended by inserting "actual cost experience and" after "reflect"; by inserting "and changes in railroad productivity, volume, and product

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mix" after "labor,"; and by inserting ", or for the fourth quarter of 1984," after "1982".

(2) Section 10707a(b) is amended by adding at the end of such subsection the following new paragraph:

"(4) If, and to the extent that, a rail rate has been changed under this subsection, or pursuant to section 10706 or 10712 of this title, such rate shall be reduced to the extent of any subsequent decreases in the rail cost adjustment factor. The Commission shall take such actions as may be necessary to ensure compliance with this paragraph. Such Commission actions shall not be deemed to constitute the prescription of maximum rates, and shall be without prejudice to the implementation of individual rate increases under any other provision of this title.".

(3) Section 10709(d)(3) of such title is amended to read as follows:

"(3) For purposes of this subtitle, in determining the revenue-variable cost percentage for a particular rail carrier transportation, variable costs shall be determined using the Commission's Rail Form A cost-finding methodology in effect as of February 20, 1985, until changed in accordance with cost accounting principles established by the Railroad Accounting Principles Board under section 11162 which have been implemented, in accordance with section 11163, by

Commission order which is final and no longer subject to judicial review.".

(4) Section 10712(a) of such title is amended by inserting before the period at the end thereof the following: "and shall take into account changes in railroad productivity, volume, and output mix, and actual cost experience".

(f) TIME LIMITS.—(1) Section 10327(a) of such title is amended by inserting "(1)" after "(a)" and by inserting after the first sentence of subsection (a) the following new sentence: "Paragraph (2) of this subsection applies to any such matter involving rail rates.".

(2) Such subsection is further amended by adding at the end thereof the following:

"(2) Except to the extent that a shorter period is applicable under section 10707(b), the Commission shall complete any rail rate proceeding and make its final decision therein by the end of the 12th month after the proceeding is commenced.".

SEC. 5. STANDARDS AND PROCEDURES FOR DETERMINING REVENUE ADEQUACY.

(a) STANDARDS AND PROCEDURES FOR DETERMINATION.—Section 10704(a) of such title is amended in the first sentence of paragraph (2) thereof by striking out "and economic profit or return (or both)" and inserting in lieu thereof

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"return"; and by striking out paragraphs (3) and (4) thereof and inserting in lieu thereof the following:

"(3) The standards and procedures respecting revenue adequacy and any action of the Commission pursuant to this subsection to determine the revenue levels that are adequate for a rail carrier within the meaning of this paragraph, shall provide—

"(A) for identification of revenues, expenses and investment base reasonably related to providing rail transportation service;

"(B) for including in the investment base of a rail carrier only those assets reasonably related to providing rail transportation service valued at original cost depreciated using straight-line depreciation over the economic life of the assets, less the amount of the deferred tax reserves of the rail carrier resulting from the use of accelerated depreciation; and

"(C) that in establishing return on investment base, the cost of capital of such carrier shall be determined using the actual cost of debt capital, and reasonable estimates of the current cost of equity capital to such rail carrier.

"(4) In any action by the Commission to determine revenue levels that are adequate for a rail carrier, the Commission shall inquire into, consider, and specifically comment on the validity of its determination with respect to—

"(A) the factors described in section 10707a(e)(2)(C), and

"(B) indicators of financial health, including but not limited to—

"(i) bond ratings, fixed charge coverage, operating ratios, debt to equity ratios, return on investment base, return on shareholders' equity, and return on total capitalization; and

"(ii) actions taken with respect to any merger or other acquisition of other business interests, and the source and cost of capital employed in any such acquisition.

"(5)(A) The Commission shall on an annual basis determine which rail carriers are earning adequate revenues and which carriers are earning inadequate revenues. The Commission shall also determine for each rail carrier the revenues required to achieve or maintain revenue adequacy within the meaning of this subsection.

"(B) Before making a determination under subparagraph (A) with respect to a rail carrier, the Commission shall—

"(i) require such carrier to submit information in a form consistent with and appropriate to

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the discharge of the Commission's responsibilities under this paragraph and paragraphs (3) and (4), and

"(ii) provide notice and an opportunity for public comment on such information and on the revenue adequacy of such carriers.".

(b) CONFORMING AMENDMENTS.—Section 10701a(b)(3), section 10707a(d)(3) (A) and (B), and section 10707a(e)(1) are each amended by inserting "through (5)" after "10704(a)(2)".

SEC. 6. EXEMPTIVE AUTHORITY.

Section 10505 of such title is amended by striking out "shall exempt" and inserting in lieu thereof "may exempt" in subsection (a); by inserting "or other persons" after "shippers" in subsection (a)(2)(B); by striking out "or" before "(2)" in subsection (g); and by inserting before the period at the end of subsection (g) the following: ", or (3) to issue any exemption with respect to any transportation unless the Commission has specifically determined that the rail carrier does not have market dominance over such transportation (within the meaning of section 10709(a)), except that the Commission may issue an exemption without making such determination if adequate public and other appropriate notice has been given and no interested person has objected to such

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exemption within such reasonable period as may be specified in the notice".

SEC. 7. ENHANCEMENT OF COMPETITION.

(a) JOINT RATES.—Section 10705 of such title is amened by redesignating subsections (g) and (h) as subsections (h) and (i), respectively, and by inserting after subsection (f) the following new subsection:

"(g) Notwithstanding any other provision of this section, in order to achieve the objective of greater intramodal railroad competition, any rail carrier providing service under a single line rate, or a joint line rate, on a particular category of traffic, between an origin and destination, upon request of a rail carrier having an actual or practicable interchange connection with such rail carrier between such origin and destination (or upon request of a shipper or receiver), shall either participate in at least one competitive joint rail rate via such interchange on such traffic with such connecting rail carrier between such points or shall publish a competitive proportional rate on such traffic to or from such interchange point. Such joint rate or proportional rate shall be conclusively deemed competitive if the ratio of revenue to variable costs realized from the division of the joint rate or from the proportional rate is no higher than that realized from the rail carrier's single line rate, or its division of such existing joint rate, between such origin and destination.

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(b) TERMINAL FACILITIES AND RECIPROCAL SWITCHING.—(1) Section 11103(a) of such title is amended to read as follows:

"(a) Notwithstanding any other provision of this subtitle, upon petition of any interested rail carrier, shipper, receiver, or other party directly impacted, the Commission shall require terminal facilities, including main-line tracks, for a reasonable distance outside of a terminal, owned by a rail carrier providing transportation in interstate or foreign commerce, to be used by another rail carrier, if the Commission finds that use to be practicable and necessary for the provision of alternative competitive rail service by the latter carrier, or otherwise in the public interest, without substantially impairing the ability of the rail carrier owning the facilities or entitled to use the facilities to handle its own business. The Commission shall take final action upon any petition requesting the Commission to require such use no later than 180 days after the filing of such petition with the Commission. The carriers are responsible for establishing the conditions and compensation for use of the facilities. However, if the carriers cannot agree, the Commission shall establish conditions and compensation for use of the facilities. Such compensation shall not exceed the costs incurred by the owning carrier in making its facilities available for use by the other carrier (including both variable costs and an allocated share of

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the fixed costs and a reasonable return, associated with the facilities actually being used by the other carrier). The Commission shall take final action to fix such conditions and compensation within 90 days after any party requests it to do so. The compensation shall be paid or adequately secured before a carrier may begin to use the facilities of another carrier under this section.".

(2) Section 11103 of such title is further amended by striking out subsection (c)(1) and inserting in lieu thereof the following:

"(c)(1) Upon petition of any interested rail carrier, shipper, receiver, or other party directly impacted, the Commission shall establish the compensation for reciprocal switching performed by a rail carrier at a level not to exceed the percentage then in effect under section 10709(d)(2) of the system average variable costs for such service, unless that carrier demonstrates that a higher level of compensation is reasonable and necessary for such switching service.

"(2) No rail carrier may cancel a reciprocal switching agreement except upon a minimum of 45 days' notice to the general public through appropriate tariff publications, unless the carrier can demonstrate that the continuation of reciprocal switching is not practicable or is unnecessary to provide alternative competitive rail service. The Commission shall suspend for investigation a proposed cancellation of a recipro-

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cal switching agreement if it determines that a shipper has utilized or would utilize such reciprocal switching for a significant portion of its current or future rail transportation needs at the facility or facilities affected by the proposed cancellation.

"(3) Upon petition of any interested rail carrier, shipper, receiver, or any other party directly impacted, the Commission shall require rail carriers to enter into reciprocal switching agreements where it finds such agreements to be practicable and in the public interest, or where such agreements are necessary to provide alternative competitive rail service. The Commission shall take final action upon any petition requesting the Commission to require rail carriers to enter into reciprocal switching agreements no later than 180 days after the filing of such petition with the Commission.

"(d)(1) In determining whether use of terminal facilities or reciprocal switching shall be provided or maintained under this section, the Commission shall not consider the adequacy of any rail carrier's revenues, or the alleged existence of competition other than direct rail competition between the origin and destination of the traffic involved.".

SEC. 8. ABANDONMENT PROCEDURE.

(a) ONE YEAR MORATORIUM AFTER DENIAL OF ABANDONMENT.—Section 10904(a)(1) of such title is amend-

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ed by inserting "(A)" after "(a)(1)" and by adding at the end thereof the following new subparagraph:

"(B) A rail carrier may not file an application under subparagraph (A) with respect to any railroad line or rail transportation included in any prior application denied under this section until one year has elapsed after such denial has become final, unless such carrier shows a substantial change in circumstance that is material to abandonment of such line or transportation.".

(b) LOCAL HEARING.—Section 10904(c) of such title is amended in paragraph (1) by striking out "45" and inserting "60" and by inserting "conduct a hearing under paragraph (4), and" before "determine"; in paragraph (2), by striking out "75" and inserting "90"; by redesignating paragraph (4) as paragraph (5); and by adding after paragraph (3) the following new paragraph:

"(4) On request of protestants who are located in any community affected by the abandonment, the Commission shall provide in one or more of such communities an opportunity for hearing on the proposed abandonment, unless the Commission for good cause finds that such a hearing is impracticable or unnecessary. The Commission may employ or contract with persons who are not regular, fulltime officers or employees of the United States for purposes of presiding at hearings under this paragraph. The rail carrier proposing the abandonment shall reimburse the Commission for the cost incurred in conducting such hearing.".

(c) LINE SPECIFIC FINANCIAL DATA.—Section 10904(d)(1) of such title is amended by inserting "(A)" after "(d)(1)" and by adding at the end thereof the following new subparagraph:

"(B) In any proceeding under this section, the Commission shall base its determination upon financial data respecting the facility proposed to be abandoned rather than system-wide or industry-wide averages. The rail carrier proposing the abandonment shall file such data as may be necessary to permit the Commission to make such determination.".

SEC. 9. STATE AUTHORITY

(a) REQUIREMENT OF CONSISTENCY.—Section 11501(b) of such title is amended to read as follows:

"(b)(1) A State authority exercising jurisdiction over intrastate transportation provided by a rail carrier which also provides transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title shall do so consistently with the provisions of this subtitle.

"(2) Any decision of a State authority exercising jurisdiction over intrastate rates, classifications, rules, and practices for intrastate transportation described in paragraph (1) of this subsection, upon petition of a party to its proceeding,

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shall be reviewed by the Commission to determine whether the State authority has entered a decision inconsistent with the provisions of this subtitle.".

(b) SCOPE OF ICC REVIEW.—Section 11501(c) is amended to read as follows:

"(c) Within 120 days after the receipt of a petition under paragraph (b)(2) of this section, the Commission shall take action on any such petition, applying the same scope of review as that of a reviewing court as set forth in section 706 of title 5 for review of a decision of an administrative agency. If the Commission determines that the State authority's decision is inconsistent with the provisions of this subtitle, it may vacate the decision of the State authority and shall remand the matter for further proceedings.".

SEC. 10. TRANSITIONAL PROVISIONS.

(a) GENERAL RULE.—Except as provided in subsection (b), the amendments made by this Act shall apply to any rail rate in effect on or after February 20, 1985, including any rail rate which is subject to a proceeding pending before the Interstate Commerce Commission or any court on such date.

(b) SECTION 229 RATES.—The amendments made by this Act shall not apply to a rate in effect on the effective date of the Staggers Rail Act of 1980 and not challenged during the 180 day period beginning on such effective date in accordance with section 229 of such Act, except that a party

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to a contract entered into during such 180-day period, or in effect on the last day of such 180-day period, may challenge a rate that would apply at the expiration of such contract.

(c) Limitations on Reparations.—The Commission shall have no authority to award reparations under section 11705 of title 49, United States Code, for any period prior to the date of enactment of this Act unless reparations could have been ordered by the Commission for any such prior period pursuant to its authority in effect prior to the enactment of this Act.

Senator **Packwood**. Our first witness today is the new Chairman of the Interstate Commerce Commission, Heather Gradison. I believe this is your first appearance before us, isn't it?

Mrs. **Gradison**. As Chairman, yes.

Senator **Packwood**. We are delighted to have you. I read your prepared statement and we would ask that you abbreviate your oral remarks. We will hold the other witnesses to 10 minutes apiece. We would ask that you abbreviate it because I think we are going to have a fair amount of questions for you.

STATEMENT OF HON. HEATHER GRADISON, CHAIRMAN, INTERSTATE COMMERCE COMMISSION, ACCOMPANIED BY JOHN HENNIGAN, CHIEF OF POLICY; DAN CAMPBELL, ATTORNEY ADVISER; AND JANE MACKALL, DIRECTOR OF PROCEEDINGS

Mrs. **Gradison**. Thank you, Mr. Chairman, members of the Committee. I welcome the opportunity to be here this morning to discuss the Consumer Rail Equity Act, a bill that I know is of great interest to the committee.

Before beginning my remarks, I would like to take the opportunity to introduce the individuals I have asked to assist me this morning.

Senator Ford, I think you will note that there are name tags before each one of them. On my left is Dan Campbell, an attorney adviser. To his left——

Senator **Ford**. Don't let anybody take your picture without them or you might be absent.

Mrs. **Gradison**. To his left is Jane Mackall, Director of Proceedings. And on my right is John Hennigan, the Chief of Policy for the Commission.

My prepared statement is a little bit longer than these remarks and somewhat different, and so I ask that it be submitted for the record.

As you can see from the Commission's testimony, the Commission does not support passage of the Consumer Rail Equity Act. We do believe that the act contains a number of provisions that reflect earnest criticism of the Commission. We have endeavored to take this criticism into account, and I would like very briefly to spell out some of the actions the Commission has taken and others that we have under consideration.

First, the Commission is unanimous in its recognition that there are real problems in the estimation of revenue adequacy. We share the intuitive sense that the railroads are improving rapidly and we are undertaking a full-scale examination to determine why our numbers do not reflect this trend.

Our Bureau of Accounts has been directed to commence a thorough review of all revenue adequacy issues and by mid-April we expect to have voted on a series of proposals for changes to the existing rules. At a minimum, these options will include proposals for a change in the treatment of deferred taxes and changes in the recognition of transport related revenue and expense—two items addressed by the pending bill.

We will also propose a method for eliminating time lag in cost of capital calculations. This will allow us to capture the continuing decline in equity and debt costs in future revenue adequacy determinations. It is my goal for the Commission to complete this work on revenue adequacy before the fall of this year.

I have another goal for the Commission. Like the authors of S. 477, I think the costs of presenting a maximum rate case may be too great for the small shipper. The Commission has been ready to issue a notice of rulemaking for noncoal maximum rates, but we have held it up to see if we cannot include some proposals to get the cost of presenting a case down. I have asked that this notice include also the expense required to present a Long-Cannon analysis. I would add, however, that the costs will decline, naturally. The costs of the first several cases under ex parte 347 (sub. No. 1) will include what you might think of as research and development expense, but as the technique is mastered, the cost of presenting a case will come down.

I would like to spend a little time on the Commission's recent work on market dominance and competitive access. You know that we have adopted proposals presented to us through rail-shipper agreements. The market dominance proposal shifts the burden of proof on geographic and product competition, so that the railroads must prove these issues. The new rules also eliminate the possibility that competition at one end of the line could be considered as competition at the other. Our new rules do about 90 percent of what S. 477 would do.

On the other hand, our new competitive access rules are not much like the proposed bill, but they do address the same problem. The rail-shipper agreement presented to us includes provisions that require notice and negotiation, and eliminate product competition and the consideration of revenue adequacy—but the heart of what they say is that the Commission should use competitive principles in deciding whether regulatory interference is justified. We want to give this a try, and we want to do so within the spirit of this negotiated agreement. We think S. 477, with its reliance on mandatory entry, is too intrusive and threatens continued investment and improved railroad plant.

The Commission is in the process of making other refinements. We have a proposal near completion on including productivity gains in the rail cost adjustment factor; we have a new agreement before us on contract rate disclosure. But I would like to turn from what the Commission is doing, and spend the remainder of my time on some of the criticism that has been directed to what we have done. And I would like to concentrate on several arguments that have worked their way into S. 477 despite their lack of much plausibility or factual support.

I would like to start with revenue adequacy. While we share this committee's concern over the apparent deficiency in the existing methodology, I would caution the committee against over-reaction. In testimony before the House Subcommittee on Transportation, after criticizing roundly—and I will admit, with some accuracy—the Commission's revenue adequacy determinations, one of CURE's private sector sponsors went on to say that "the resulting apparent revenue inadequacy is, in turn, relied upon to justify the reasonableness of rates to captive shippers." This is simply not the case. It is not the case with the rules set out in ex parte 347 (sub No. 1), and I do not know that it ever was the case. We do not allow the fact of revenue inadequacy to justify a rate increase. The rate must be justified on the grounds of economic efficiency. That was the reason for creating the stand-alone limit on coal rates. And I would note that under our new competitive access rules, we are foreclosed from considering revenue inadequacy as a justification for anticompetitive behavior.

I would also like to say a few words about criticisms directed to the stand-alone cost test. That test is designed simply to determine the current resource value of the assets being consumed in serving a group of shippers. It is another way of asking what is the least cost way to run a competing railroad.

It is frequently characterized as the cost "to build and operate a new railroad," but in a very important sense, it is not the cost of building a new railroad. We do not include what the economists call barrier costs. We assume instantaneous, risk-free entry. This means that there are no construction financing costs, no uncertainty in legal expense surrounding land acquisition, no environmental studies or licenses, and no need to amortize startup costs incurred waiting for traffic to build—in short, nothing that would inflate the newcomer's cost as a result of the building process. What we get from stand-alone analysis is a minimum simulated competitive entry price, and that mouthful is what I think it should be called, so that we can avoid the horror stories about the Commission forcing shippers to build their own railroads. That is not what we require.

I also would like to respond to the argument that no other regulatory agency uses our approach to maximum rates. I will assume, because I do not know, that in fact no one else does use this process of simulating competitive service. It is brand new, so that comes as no surprise. But I would hasten to suggest that perhaps some should give thought to its use. People more informed about electricity generation than I have suggested that there is a problem defining excess generating capacity. We all know there is controversy over how to handle investment in nonproductive nuclear facilities. I think that our stand-alone or competitive entry analysis has the possibility of useful application here, as well because what it does, first and foremost, is eliminate excess capacity and nonproductive investment.

Let me turn to market dominance, another area where I think a lot of criticism has been misplaced. I earnestly hope the committee realizes that the ICC's rules have never been the insurmountable barrier that some make them out to be. In testimony before the House Subcommittee on Commerce and Transporation, one of the supporters of the House version of this legislation said "market dominance became much more of a barrier to entry into the ICC jurisdiction than was envisioned by shippers and the Congress when Staggers was enacted." I would like the committee to judge for itself how much of a barrier our rules—and this is before revisions—how much of a barrier our rules really were.

A recent GAO report, prepared for a Member of the other body, discusses market dominance findings. GAO identified 59 cases in which the Commission has made market dominance findings. In over 77 percent of these cases, the Commission—not an administrative law judge, but the Commission, found that market dominance existed. Significantly, GAO reports that in all cases involving coal shipments, the Commission found market dominance. GAO has us down as batting 29 for 29 on coal cases, although frankly I think they may have missed one involving barge competition. I am not saying that there are no difficulties, but difficulties should be kept in perspective. On those commodities where the framers of Staggers expected a finding of market dominance, they have been getting it.

Let's turn to what happens after we find market dominance, because we do find it much of the time. What happens when we get to rate reasonableness? The answer coming from our critics is that we lean over backward to uphold whatever rate the railroad proposes. The proof offered is that there are no cases in which the Commission has granted shipper relief.

What should you make of that? The first fact to consider is that we do not have a lot of rate cases—only 37 of the 49,000 tariffs that were filed in fiscal year 1984 were protested—37 out of 49,000. That is not the result of hopelessness on the part of the shipping community. It is due to the plain and simple fact that the railroad rates are not rising unreasonably fast. Staggers was enacted to make railroads self-sufficient, and you might have suspected that some of this self-sufficiency would come out of the hide of shippers. But, by and large, it has not. It has come out of productivity. If inflation is factored out of rate increases, many commodities show little rise and some show real reductions.

Even where increases are shown, the numbers are not big. As a result, the Commission does not have a large docket of rate cases.

Another factor that you must recognize is that most of the celebrated cases have yet to be decided. It is regrettable that these things have taken years, and it may be possible that refunds will not ever make anyone whole. But the refunds should go a way toward doing just that.

The people have had to wait, but the delay is proportional to the complexity of maximum ratemaking in the presence of competition. We are not a public utility commission and our task deals with both competitive and captive shippers.

For the first time in nearly a decade, the Commission finally has rules in place that will allow it to decide maximum coal rate cases with some confidence of court approval. These rules are workable and will protect captive coal shippers from monopoly abuse.

The Commission is now in the process of deciding a number of its oldest and toughest cases. These are our top priority and I urge you to await the outcome before passing judgment on Staggers implementation. We finally have the tools in place and I would like to see us have an opportunity to implement them.

This concludes my prepared remarks. My staff and I would be happy to answer any questions that each of you may have.

Senator **Packwood**. Let me ask the clerk to hold the committee members pretty close to our 5 minutes, because I think we will go through several rounds of questions. A lot of members are here, and if we use up all the time at the start, all members will not get the same chance to ask questions.

Madam Chairman, take me through again your figures on the 61 out of 81 market dominance cases and 29 of 29 for coal. Repeat that to me.

Mrs. **Gradison**. Let me get Dan Campbell, our attorney adviser, to address that, please.

Mr. **Campbell**. Senator, those figures come out of a report that was prepared for Congressman Marlenee, and I have the report here in front of me. What they show is there were some 81 cases in which a market dominance finding was made at some level in the Commission.

Senator **Packwood**. Say that again? There are 81 findings of market dominance?

Mr. **Campbell**. There are 61 total cases in which a market dominance finding is made at the Commission or has been made at the Commission, in which the Commission——

Senator **Packwood**. Wait a minute. Slow down. You had 81 cases filed, or you had a whole lot of cases filed, of which a judge has found 81 cases of market dominance and the Commission found 61?

Mr. **Campbell**. The GAO surveyed the Commission's docket and found 81 cases on which the remainder of this report is based. In those cases, I will read right across the bottom line, they found 81 cases. In 15 cases an ALJ found that there was market dominance. In 46 cases the Commission found that there was market dominance. In 5 cases an ALJ found the absence of market dominance, and in 13 cases the Commission found the absence of market dominance.

What that translates into at the Commission level is 59 findings; 46 for market dominance; 13 not market dominance. That is an average. That is a percentage of 77 percent.

Senator **Packwood**. And in all of the cases involving coal, you found market dominance?

Mr. CAMPBELL. At the Commission level, that is correct.

Senator PACKWOOD. Now, Madam Chairman, when you found market dominance, in the coal areas what then was your subsequent action?

Mrs. GRADISON. Let me let John Hennigan answer that.

Mr. HENNIGAN. Senator, those cases, they would then be decided for rate reasonableness. For these market dominance cases, many of those cases have been decided—some of those cases would probably still be before us. As we point out in our testimony, there is a part of the GAO analysis which discusses the resolution of those cases with respect to rate reasonableness.

Senator PACKWOOD. And what was the result? Let me ask those of you who are answering these questions, do you know the answers yourselves, or are you simply quoting from this GAO document?

Mr. HENNIGAN. The GAO document is theirs and illustrative of this issue. We have also been asked this question.

Senator PACKWOOD. Can you give the answer yourself without the GAO document?

Mr. HENNIGAN. Yes, we can. We have responded to Senator Long after the last hearing about the number of cases where we have found for shippers. We have basically done the same sort of analysis, Senator. We can give you data on the number of cases we currently have in front of us.

We are trying to determine, just like GAO did, the number of cases that have existed since Staggers Act. It is a tedious process to go back and find the number of cases.

Senator PACKWOOD. Let me ask it another way. What did you do in those coal uses when you found market dominance? Did you order reductions in the rates, or what happened?

Mrs. GRADISON. We have our coal rate guidelines in place. Those were just approved in the fall of 1985. Those cases are now before the Commission. They are our top priority and we are about to process them to determine what the results will be with the application of those guidelines.

Senator PACKWOOD. So at the moment, you have not decided any?

Mrs. GRADISON. We have 34 that are still before us and we should be cranking out those results this spring and summer.

Senator PACKWOOD. Thank you. That is a fair enough answer. Now that you have become Chairman, you will crank them out rather fast?

Mrs. GRADISON. Well, that is my hope. We have had to dive into the bowels of the agency to see what is there and it is our goal to move all the paper that is in the building, so that we can stand on our record, rather than stand on what we hope to do.

Senator PACKWOOD. In 1984 Senator Danforth, as you will recall, introduced a joint resolution directing the ICC to make changes in five areas of regulation: Market dominance, revenue adequacy, rate reasonableness, joint rate cancellations, and contracts.

So far, what has been your response?

Mrs. GRADISON. Well, I am pleased to tell you that each of the matters that were raised have been addressed. First of all, in our recent market dominance decision ex parte 320 (sub. No. 3), we decided that the burden of proof for providing evidence of product and geographic competition would be on the railroads. They have to prove that such evidence exists and that competition is a real restraint on rail rates.

In ex parte 347 (sub No. 1), coal rate guidelines, we eliminated the 15-percent phase-in provision and elaborated on the concept of grouping and stand-alone cost. The Commission has adopted rules governing competitive access in ex parte 445 (sub. No. 1). Also our joint rate study should be available in the next few weeks.

With respect to rail contracts, we have interim rules on discovery. We will shortly seek public comment on the agreement between the parties with respect to raw grain and soybeans.

And finally, we have directed our Bureau of Accounts to present to us an options paper to consider the whole question of revenue adequacy computation. This is an area of concern among the entire Commission, and that is why it is under new review.

Senator **Packwood**. Senator Rockefeller.

Senator **Rockefeller**. Thank you, Mr. Chairman.

Madam Chairman, the market dominance question is not really so much at issue here. The bill fairly well incorporates the basic ICC standard, but isn't the problem that a finding of market dominance only gets the shipper in the front door? That does not do anything. In other words, from that point, the burden is still on the shipper to prove that the rate is unreasonable. Is that not correct?

Mrs. **Gradison**. That is correct.

Senator **Rockefeller**. So a finding of market dominance does not, in and of itself, do anything to help the shipper. It just allows the shipper to prove on his own, so to speak, that the rates are unreasonable.

Mrs. **Gradison**. Well, it is not necessarily on his own, Senator. The guidelines are fairly clear in spelling out what needs to be done. And as I said, we are about to begin the review of those cases. We finally have the guidelines in place and now we can use them to make the determinations of rate reasonableness.

Senator **Rockefeller**. May I ask you a series of questions, please, until my time runs out?

With respect to revenue adequacy determinations, in how many cases has the Commission found a rate unreasonable where there has been a finding of revenue adequacy?

Mrs. **Gradison**. We have not made any rate reasonableness determinations based upon revenue adequacy. That is not the sole factor that is used.

So, the answer is none.

Senator **Rockefeller**. Is there any railroad which you have found to be revenue adequate?

Mrs. **Gradison**. As I stated in my opening remarks, we are reviewing the revenue adequacy standards because we think the methodology is flawed. The answer to your question is no, not at this time, and that is one of the reasons that we are examining the methodology. It does not seem to be giving the results that we would have expected it to give.

Senator **Rockefeller**. Will the revenue adequacy review to which you just referred include either the current cost of debt issue or the issue of deferred taxes in the rate base?

Mrs. **Gradison**. Yes; it will address those issues. This is one of the areas in which we have heard your concerns and we are responding. That is why we are here today, and that is why the long opening statement, to attempt to address the concerns that you, on this committee, have stated publicly and to us at the Commission. We are attempting to be responsive to those concerns.

Senator **Rockefeller**. But either of those will be—or both of those will be——

Mrs. **Gradison**. They certainly will be considered. Yes, sir.

Senator **Rockefeller**. The stock of the three major coal hauling railroads, since the passage of the Staggers Act, has basically risen or fallen in your judgment?

Mrs. **Gradison**. I have not reviewed the stock of those carriers, but I know that I did not do too well when I had to sell all of mine.

Senator **Rockefeller**. Well, you might have made a wrong decision. CSX stock, Mr. Chairman, for the record, has risen from a high of 49⅜ in late 1983 to 77½, and then there was a three-for-one split. From that base, it went from 27½ in 1983 to a current 36.

Norfolk Southern's stock has risen from a 1982 high of 65 to a 1986 high of 91.

Burlington Northern, 1981 high of 72 to a 1984 high of 100, then a two-for-one split, and then from 50 to a 1986 high of 77.

You should have kept the stock.

Mrs. **Gradison**. Well, the problem is beyond ethical standards. No, seriously, the problem is that those stocks are for the holding companies, not just the rail carrier interests. And so when you review the numbers, it is difficult to separate the railroad portion from the holding company itself. So I do not think that the stock prices are necessarily reflective of the overall vitality of the carrier, and that is another reason we are looking at revenue adequacy.

Senator **Rockefeller**. But, for example, for Norfolk Southern and Chessie, the stock values are reflective of debt retirement and enormous revenue, aren't they?

Mrs. **Gradison**. Yes.

Senator **Rockefeller**. You have said in essence to us this morning: "Trust us; we are going to resolve these problem areas at the ICC." And you have also said that the ICC has already responded to the problems that we have raised in a variety of ways, including the Coal Rate Guidelines, and that the ICC intends to do more. This is all good stuff.

Now, let me review this further. First, you do or do not support the President's proposal to abolish the ICC?

Mrs. **Gradison**. As one member of the Commission, I am supportive of the administrations proposal to consider transferring the rail functions to the DOT. And the result would be to abolish the agency. The rail functions must be continued, but whether it is at the ICC, the DOT, or the Justice Department, it is up to you, the Congress. And my recommendation is simply that I, as one member of the agency, do not think it is necessary to have an independent agency to continue for all of the surface transportation functions that our agency is currently responsible for.

Senator **Rockefeller**. In the matter of Coal Rate Guidelines, do you still use the revenue adequacy test as a threshold standard to

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measure the reasonableness of the rate charged to a captive shipper?

Mrs. **GRADISON**. No. It is a consideration. But again, because the methodology is flawed, the answer is no.

Senator **ROCKEFELLER**. Mr. Chairman, I will pass for the moment.

Senator **PACKWOOD**. Senator Long.

Senator **LONG**. I just wanted to review the matter that I inquired about before.

Mrs. **GRADISON**. I am sorry. I cannot hear you.

Senator **LONG**. I will try again. I want to review the matter that I inquired about before when the Commission was before us. I wrote to the Commission and I believe to you, as Chairman of the Commission, Mrs. Gradison, and I asked if would you please give us a statement of the number of cases in which relief had been granted to a captive customer.

And you responded to my inquiry with a list of 17 cases; is that correct?

Mrs. **GRADISON**. Yes, sir.

Senator **LONG**. Now, there had been over 800 cases filed, I believe.

Mrs. **GRADISON**. That is correct.

Senator **LONG**. Now, if you just stop at that point, that is not much of a win record for lawyers, you know. I am not through, but if you have a comment, go ahead.

Mrs. **GRADISON**. I will listen to your question.

Senator **LONG**. Well, if I were a lawyer and somebody came to me and wanted to fight the matter out in the courts, I am not sure that I could justify even paying me a fee to look into it, if so far the people with winning cases were winning only 2 percent.

But let's go on now. I have had a chance to review your response on these cases, and so has the staff of the House Commerce Committee. Now, here is what they contend and what my advisers advise me.

Of the 17 cases in which you cite relief is granted, is it not true that 3 of them were cases in which the administrative law judge decided in favor of the shipper at some point, but then was reversed by your Commission, so that the law judge decided for the captive shipper, but the Commission reversed it in favor of the railroad.

Mrs. **GRADISON**. I would like to help put those numbers into perspective, Senator.

Jane Mackall, our Director of Proceedings, is the one who helped compile the data for you. I would like her to address both the 800 cases and how the 17 is not representative of those that were settled.

Ms. **MACKALL**. Thank you. Senator Long, the 800 cases you discussed were the section 229 Staggers Act cases, the savings provision cases. Most of those cases never reached final decision. They were dismissed by the parties once the parties settled. So the comparison to the 17 is not really accurate.

The number the 17 needs to be compared to is between a 60 and 80 number of cases that the Commission has before it in adjudication.

Senator **Long**. Well, let's talk about the 17. Of the 17 cases, my question is were not 3 of those cases ones in which the examiner or the administrative law judge recommended relief?

Ms. **Mackall**. That is exactly right.

Senator **Long**. OK. Now, of the remaining 14 cases you cited granting relief, 9 of them are pending upon reconsideration now to review either the market dominance determination or the maximum reasonableness determination under Commission guidelines; is that correct?

Ms. **Mackall**. That is correct.

Senator **Long**. So that is 14 more of your cases. Now, no final decision. The Commission is talking about reopening them and either deciding on market dominance or on the rate reasonableness, so that is not a final decision for the captive customer.

Ms. **Mackall**. That is right. That is because we had the 347 (sub. No. 1) guidelines pending and did not have any standards. Now, the five cases that are left were administratively——

Senator **Long**. I want to ask you about them. These five cases now that you cite as granting relief are all cases that were ultimately dismissed either after a withdrawal of a complaint or some other action by the Commission. Is that correct?

Ms. **Mackall**. That is correct.

Senator **Long**. In only one of the five cases was an agreement reached after some sort of favorable decision by the full Commission. Is that correct?

Ms. **Mackall**. I do not know about that. My information is that they were dismissed, and our conclusion is that the Commission decision had to have some role in that.

Senator **Long**. I understand. But no final decision for the captive customer. All right.

Now, in fact, it leaves three of those, in which accord was reached after the full Commission proposed either to reverse or to reopen the case in which the administrative law judge decided in favor of the shipper. Is that correct? That is what I have been informed by the House staff.

Ms. **Mackall**. Yes.

Senator **Long**. I would certainly question whether you cite any more than perhaps one case, perhaps one out of all of those cases in which you could say, well, a decision was won for the captive customer.

Mrs. **Gradison**. Well, of the 800 cases that we had, the results are based on market decisions. These are cases that are negotiated between the shipper and the carrier and the results have been a private sector solution which the Staggers Act encourages, which the Interstate Commerce Commission encourages, that the results are equitable to both parties, rather than having the Government dream up a solution. The parties came to terms with one another and resolved their differences.

For the situations in which the parties cannot resolve their differences, we work very hard to come up with a fair and equitable solution to those cases that are now pending before the Commission for the implementation of the coal rate guidelines.

Those are the cases that will be coming before us in the next 6 months, and those are the cases that I have asked you and the other members of the committee to give the Commission an opportunity to use these guidelines to make the analysis and make the determination to provide for fair and equitable rates for captive shippers.

Senator LONG. Let me just make this point. It seems to me that the record here shows that since the Staggers Act went into effect—how long is that, about 6 or 7 years ago?

Mrs. GRADISON. It was passed in 1980.

Senator LONG. Since the Staggers Act went into effect, just in general terms, the way I would put it from a lawyer's point of view, the captive customers have not won any, just none.

There has been virtually a complete—well, I would say a 99-percent victory or 99.5-percent victory for the railroads over the customers. And if someone comes to you as a lawyer—the captive customers are not the richest people in the world, and they come to you with a problem and they ask about relief, it seems to me anyone who is familiar with this record would have to say well, I am sorry to tell you, you do not have a chance.

Now, Mr. Reid Thompson is going to come up here and testify for the private power utilities, the so-called investor-owned generating plants in America. I believe that is going to be his testimony, that based upon the way this thing stands today—and mind you, they can afford to pay—I think that it is a waste of time for them to go to court or to go before your Commission the way it stands now, and that is why we seek to amend the law.

Now, if it is the law that is inadequate, and I suspect it is, then maybe we should not be rough on you people on the Commission. Maybe we are riding the wrong horse. But I, for the life of me, cannot say that when you have no clear-cut case where the captive customers have won—as former chairman of the Monopoly Subcommittee, I say this looked to me in the beginning like a case where the captive customers were going to take a beating, and I think the record shows they have taken a beating and no relief is in sight.

And for you to come here and say well, look, give us more time, and you try to show us where something has been done for the captive customers. I do not see it. And therefore, it seems to me the problem is there. That is a problem that caused railroad regulation in the beginning, and it still exists.

I thought we were doing a little something about it, we tried to, but it looks to me as though we have to try again. But where is your prime case? Can you show me something where you really achieved something for a captive customer?

Mrs. GRADISON. Senator Long, I think the proof is in the health of the rail industry today. I think the proof is in that.

Senator LONG. The rail industry, sure. I am talking about the customer, the poor soul that is getting squeezed out.

Mrs. GRADISON. The customer now has service available that perhaps was not available in 1980. The story that DOT always refers to about the derailments of cars that are standing still on the track applies. I think shippers today have better service, more options, better equipment than they have ever had since 1940, and that is the proof that the Staggers Act is working.

Senator **Long**. Now, if I recall correctly, you have not found that there is a railroad in America that is revenue-adequate; is that correct?

Mrs. **Gradison**. Yes, sir; that is correct. And that is why we are looking at the methodology by which revenue adequacy is calculated. I do not believe it.

Senator **Long**. Could I just ask one further question?

Senator **Packwood**. You have had one further question.

Senator **Ford**. You can have my time.

Senator **Long**. Norfolk Southern came in here with $1.2 million and a lot of influence to see if they could buy Conrail. And I am not criticizing them. I voted for it in the end after I voted for an alternative. But they had $1.2 million to come in here and fight to buy the Conrail, and did, and they are still being deemed revenue inadequate. Isn't that right?

As of right now, Norfolk Southern is regarded as revenue-inadequate, even though the Secretary of Transportation came and said this is a company with deep pockets and plenty of dough, and they are just doing great?

Mrs. **Gradison**. Yes, sir.

Senator **Long**. Thank you.

Senator **Packwood**. Senator Ford.

Senator **Ford**. I was enjoying Senator Long.

There is something wrong when Senator Long, in his eloquent way, says that the shipper has never won a case and the Staggers Act has been in place 5 or 6 years. I see coal shippers—and I think my friend here on my right from West Virginia can substantiate that—many of our shippers are still using their own locomotives, picking up the unit car and loading it, taking it back to the railroad, paying for engineers to come from Cincinnati to deep eastern Kentucky. Just to get on a train, paying for all of those things, doing all of those things.

Yet, they are the shipper, and they have never had a case found in their favor to date. And yet, they have been paying through the nose for years and years and years.

What change in the direction of ICC has occurred since the legislation under consideration was endorsed or Senator Danforth's resolution was introduced? Have you accepted any change? Have you attempted to make any change? Or has it forced you into making some changes?

Mrs. **Gradison**. Both.

Senator **Ford**. That is some answer.

Mrs. **Gradison**. It is honest. We hear your criticisms and we are trying to respond.

Senator **Ford**. Let me ask you a question. Today a shipper says that he cannot make it under the present rail rates, that they are just too high. He wants to object.

He goes to the bank and borrows the money to have sufficient representation. How long from the date of his decision can he beat the railroad if you agree with him? How long would it take him to get that case through?

Mrs. **Gradison**. We are concerned about the small shipper.

Senator **Ford**. I understand that. I know you are concerned about everything. Just give me an answer.

Mrs. **Gradison**. I wish that I could, and I do not know.

Senator **Ford**. What is the average time it takes to get a rate through? Two years? Three years? Four years? Five years?

Mrs. **Gradison**. Let me turn to Director Mackall. She is in charge of the Office of Proceedings. She is in charge of how long it takes to process these things. She has been serving in this position 2 months. Let's ask her.

Senator **Ford**. If we filed today, and you have your way, there will not be a Commission there to hear it.

Ms. **Mackall**. If you filed a complaint against an existing rate, I would say that there would be a decision by a division of the Commission or the entire Commission within 9 or 10 months, provided the parties were able to put the record together within 6 months.

OK, it is record building that takes the time.

Senator **Ford**. All right. Well, let me ask you another question then.

What has been the average until today?

Ms. **Mackall**. It is not fair to use such an average because the Commission has been changing its standards. Until it agreed to——

Senator **Ford**. That does not make any difference, and I know what you are trying to do to me, and I am just not going to let you do it.

How long has it taken a case, until today, to get through the Commission? What is the average time?

Ms. **Mackall**. Many of the cases are through the Commission and they have been dismissed. We have now about 20 pending coal cases. The average time for those pending coal cases is in years. I admit to that.

Senator **Ford**. Five cases, 6 years?

Mrs. **Gradison**. And that is why those cases are our top priority.

Senator **Ford**. It is about time, isn't it?

Mrs. **Gradison**. I have only been Chairman for 2 months.

Senator **Ford**. Well, look, you don't even want the Commission to exist. You want it to be transferred someplace else. Whatever the Commission does, you really don't care because you want to abolish it in my opinion.

And maybe I should not have said you don't care; maybe you care a little bit, just to keep it afloat until you can get it into the Department of Transportation or the Department of Commerce or somewhere and make it worse, probably, than it is now. And that is hard to believe.

But two points I think we ought to make as they relate to the changes that we are asking for in this legislation. One, a shipper has not had a case found in his favor yet.

Two, even if everything goes right and if all the parties can get all of their papers together in 6 months—you know the railroad is not going to get it together in 6 months, and you know they are going to ask for one extension, and they have the ability to do it against that little fellow down in Hazard, KY, or Harlan or Morgantown or wherever, the shippers are not going to have the ability to stay and stay and stay.

And you know what is going to happen. You gave me the hypothetical perfect, which is 10 months. And that was hedged "if."

And that "if" is not going to occur under the present circumstances, and you know it.

You have not had one case yet to be a hypothetical, I mean to be perfect, let alone figure out what hypothetical perfect is. Now, am I about right? Am I reasonably right?

Mrs. GRADISON. Yes; you are right. And under the CURE bill that problem will not be solved either.

Senator FORD. Well, at least we have your attention.

Mrs. GRADISON. Yes, sir.

Senator FORD. Thank you, Mr. Chairman.

Senator PACKWOOD. Senator Danforth.

The CHAIRMAN. Madam Chairman, let me just state my own position very briefly. I think that the Staggers Act has been the salvation of the railroad industry in this country. I think without it, the railroad industry would be in very, very desperate condition.

I also think that by and large, the Staggers Act has, by keeping railroads going, been better for shippers than had it not been passed. It is my understanding that since the Staggers Act was enacted, the average coal rates adjusted for inflation have increased only half a percent annually.

Now, I do not support the CURE legislation. I do not support opening up the Staggers Act by an act of Congress. But I do believe that in order to make the act work effectively, it is very important to have the ICC be responsive to the needs of shippers, especially captive shippers, and I do think that it is essential for aggrieved shippers to believe that they have a reasonable chance of prevailing if they present a good case before the ICC.

Therefore, my hope would be that the ICC, rather than Congress, would be very forthcoming in solving the problems that the shippers face.

Now, let me ask you just two questions. First, what has been the result of the Staggers Act as far as keeping the railroads going is concerned? Am I correct, in your view, in my assertion that the Staggers Act has saved the railroad industry? And am I also correct in my belief that by and large, the result of the Staggers Act has not been a stupendous rate increase to the coal industry or to any other industry?

Mrs. GRADISON. You are correct in both of those, except I would make one change. The Staggers Act has saved the shippers, not just the railroads. The Staggers Act has provided the shippers with rate options they never dreamed of. Senator Packwood provided an example that made it clear that shippers and carriers can now negotiate where they did not used to be able to negotiate.

Shippers and carriers can now make agreements on a timely basis to provide for service that did not used to be available. Shippers and carriers can take advantage of the equipment that used to sit idle because it was too expensive to move. Now they can move it.

Those are just a few examples of how the Staggers Act is working for shippers. Carriers are now willing to reinvest in themselves. This cash cow that is referred to about the Norfolk Southern, the Commission is not involved in the Conrail sale, but I must say that if a railroad is willing to make that type of major investment in a railroad, we have now turned the corner to provide a willingness within the rail industry to reinvest in their own industry. This is new.

The CHAIRMAN. Is it fair to say that prior to the enactment of the Staggers Act, the rail industry was a sick industry in this country?

Mrs. GRADISON. Yes, sir.

The CHAIRMAN. Now, I think that you have gathered from some of the questions that have been asked and some of the comments that have been made, that at least among members of this committee there is a strongly held view that the shippers who do have complaints just cannot get relief from the ICC, and a lot of shippers feel that way as well.

Senator Long raised some factual matters, presented some statistics indicating that in the past, shippers who do have complaints get nowhere and that it is a lost cause to go to the ICC.

Now, what kind of assurance can you give that it is not a lost cause? What is your answer to this demand for a legislative solution to what I believe should be a matter handled by the ICC?

Mrs. GRADISON. First of all, their complaints are not unfounded. It has taken far too long to process the complaints which have come before the Commission. We now have the guidelines in place to address those problems.

With regard to the CURE legislative proposal, some of the elements of that legislation would take longer to provide results for those aggrieved shippers than the system that we currently have in place. I could go through a litany of what it took to put the maximum rate guidelines in place, from the midseventies all the way through 1985, what happened in the courts, what happened at the Commission and why it took so long, and I would be happy to submit this for the record.

But my argument and my response and my sincere hope is that because we do now have those guidelines in place, which the Commission unanimously approved this past fall, I think that the time is finally at hand where we can process those cases and have balanced results.

[The following information was subsequently received for the record:]

A. Here is a chronology of events.

Pre-mid 1970's—used rate comparisons primarily (for all commodities).

Mid 1970's—Western coal movements just beginning. No Western coal commodity rates available to compare to a challenged rate. Eastern coal rates could not be used for comparison because movement data were not comparable.

1977—Adopted Fully Allocated cost (FAC) test (using historic cost of capital) through adjudications.

1978—Changed FAC test to use current cost of capital to properly reflect Y-R Act policies

Began Ex Parte No. 347 to set standards for Western coal only.

1979-80—Adopted "7% solution" in a number of adjudications (7% over FAC). Rejected by court.

1980—Ex Parte No. 347 renoticed to cover coal rates nationwide and to propose a new costing method (ton/ton-mile), which allocated more fixed cost to long distance, heavy-loading commodities (like coal). (Case retitled and renumbered as Sub-No.1).

1980-1981-Ton/ton-mile approach applied in various Western coal cases. But we found that it produced distorted, unreasonable results in the East. (It would have required substantial reductions from existing rate levels that were not being challenged).

Non-coal case using rate comparisons reversed in court.

Approximately 800 Staggers Act Section 229 cases filed.

1981—Ex Parte No. 347 renoticed to withdraw ton/ton-mile proposal. Concept of differential pricing adopted. Interim rules adopted providing for case-by-case approach until rulemaking completed.

1982—Various cases decided by ALJ's and Commission without any real standard. Some parties asked that their cases be held up pending final decision in 347(1).

1983—347 (Sub-No. 1) renoticed to propose Constrained Market Pricing (included stand alone cost constraint).

NIT League filed petition for rulemaking seeking standards for non-coal commodities (Ex Parte No. 454).

Mid 1984—Record in 347(1) closes.

Oral argument held.

Pending coal and non-coal cases formally held in abeyance.

NIT League petition denied.

1985—Final decision in 347(1) issued September 3, 1985.

Petition to reopen and clarify received from Arkansas Power & Light (pending).

Judicial review pending.

Issuance of 347(2) addressing non-coal commodities pending.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator PACKWOOD. Senator Gorton.

Senator GORTON. Thank you, Mr. Chairman.

Madam Chairperson, I am going to give you a chance to talk about a different subject. I understand the key parties in the boxcar deregulation dispute; that is, BRAE, ITEL, Conrail and the short line railroads, filed a settlement proposal on behalf of all of them with the Commission more than 9 months ago.

Recently, during testimony before the House Subcommittee on Commerce, Transportation and Tourism, you made comments that certainly could lead members of that committee and this one to believe that you do not know whether the ICC has legal authority to reach a decision in that proceeding.

If you feel that you do not have such authority, we would certainly like to know about it, since this has been going on for a number of years, and not wait until the Commission may no longer be in existence.

I would just like to ask you very specifically, do you believe that you have legal authority to adopt the short line Conrail compromise or don't you?

Mrs. GRADISON. Let me turn this to the policy adviser, John Hennigan, please.

Mr. HENNIGAN. Senator, we are certainly concerned when we review a private sector agreement, that it must comport with the law. As in the ex parte No. 445 competitive access rulemaking, part of the Commission's deliberation was that it must be consistent with the law.

In the Conrail-Brae short line agreement, we are concerned that it does comply with the law and that is——

Senator GORTON. You have not answered my question at all. You have had this petition before you for 9 months. When are you going to decide whether you have legal authority to deal with it?

Mr. HENNIGAN. Senator, first of all, we did put that agreement out for comment in November, and the comment period is now over. The comments are in as of February 3.

Senator GORTON. The comments on its legality?

Mr. HENNIGAN. Yes, sir. And the appropriateness of the agreement. I looked this morning and noticed that quite a few of the comments were filed as late as February 3. There does still seem to be some disagreement over the agreement.

The Commission presently has the comments before us. It has had it for 2 weeks, all of the comments. We put the agreement out as a notice of proposed rulemaking which is required by the Administrative Procedures Act, and so now it is before the Commission for final resolution.

Senator **Gorton**. Well, kindly give me an estimate as to when you are going to have an answer to either of those questions, either to whether you have authority to deal with it, or what you are going to do about it.

Mrs. **Gradison**. Senator, I share your concern with the length of time it has taken us to give you a response to the boxcar problem. And believe it or not, following the Administrative Procedures Act, this case has been on a fast track. It is not the encumbrances provided by the Commission necessarily. It is just following the rules for public comment, for negotiation by the parties, for review by the Commission and then back out.

Senator **Gorton**. I sort of feel like Senator Ford. I would still like to get some kind of estimate on your part as to when you are going to reach the end of this process. I understand it takes a long time.

Mrs. **Gradison**. Well, we anticipate having a response to the proposal that is before us in the next 2 months. But, Senator, that does not mean that the agreement will be approved. It does not mean that the agreement will be disapproved.

Senator **Gorton**. It does not mean that I am going to like it, but as long you said you will have something in 2 months, at least you can give me some kind of indication of where you are going.

Mrs. **Gradison**. We will.

Senator **Gorton**. Just simply to repeat it, this issue started a long time ago, long before this petition was done. It has already gone to the floor of the Senate on two separate occasions, and those of us who are very interested in it simply need to know whether or not we should wait any longer or should introduce legislation on the subject

I am sort of encouraged by a 2-month prediction. I perfectly well understand that I may or may not like what the decision is, but we cannot make up our minds what to do unless we know that we are going to get a decision. And for that I thank you, and maybe I did a little better than you did, Wendell.

Senator **Ford**. Well, it seems the more you push, the better answer you receive.

Senator **Gorton**. Thank you, Mr. Chairman.

Senator **Packwood**. Senator Gore.

Senator **Gore**. Thank you very much, Mr. Chairman.

Madam Chairperson, I would like to begin by joining the concerns just expressed by my colleague, Senator Gorton. This continuing delay by the Commission in resolving the boxcar problem is of extreme interest in Tennessee, particularly in southwest Tennessee where thousands of jobs could be lost unless the Commission acts.

It has been lingering for a long, long time. It is a serious threat to short line railroads, not only in Tennessee but throughout the country, and there are other members of this committee and other

Members of the Senate who are extremely concerned about this as well, and it is simply a question of delay and delay and delay.

I want to add my voice to his in encouraging you to get to the bottom of why this is taking so long and get a decision out on it.

Mrs. **Gradison**. Yes, sir. I appreciate that.

Senator **Gore**. There are a couple of other issues that I would like to explore in my 5 minutes. I was going to spend most of my time on the captive shipper problem, but I think that the interchanges which have already taken place are quite devastating, if I may say, particularly the questioning by Senator Long, where he illustrated that out of 800 applications there may have been one in 6 years that has resulted in a favorable decision for captive shippers.

Again, this is a problem of concern in Tennessee as well, and I disagree with your view that this legislation is not needed, because I think the record that has been explored here already provides very strong support for the proposition that legislation has to be approved.

I do not disagree with your assertion that the Staggers Act has been good for the railroad industry and has been good for some shippers, but I disagree that it has been good for all shippers. There have been winners and losers, and some of the captive shippers have clearly been losers. That is why some changes are necessary, in my judgment.

There are some other losers that I would like to ask about, and that has to do with small factories in rural areas. Approximately how many abandonment applications have been filed at the ICC since the passage of the Staggers Act?

Mrs. **Gradison**. I have the numbers for you. I would be happy to submit them for the record. Of those filed, granted, denied, and dismissed——

Senator **Gore**. Could you just read them off? How many have been filed, first, since Staggers?

Mrs. **Gradison**. Specifically, we have had 19,000 miles requested for abandonment; 15,000 miles of those 19,000 miles have been granted; 920 of those 19,000 were denied; and 1,500 were dismissed. That is miles. If you want the actual number of cases, there were 1,300 cases filed; 1,200 granted; 23 denied; and 88 dismissed.

Senator **Gore**. So the relevant statistic then is out of 1,300 applications, only 23 of them have been denied; correct?

Mrs. **Gradison**. That is correct. The reason for the numbers, the reflection of those numbers is that the applications are not made unless the carriers have a darn good case. You are not going to go to court and try to win anything unless you can provide the data that is necessary in order to win. So, I think that the Commission now is faced with some really tough abandonment questions that will be coming before us in the next 2 years. Prior to that time, we had some specific elements in the statute. For example, Conrail, and the NERSA requirements were such that it was very, very difficult for the Commission to deny any abandonment under the NERSA if the carrier met its burden of proof. We have pretty well completed all of those and now I think you will be seeing fewer abandonment applications as well.

Senator **Gore**. Well, again, we find it difficult to base legislative action on hopes and promises for the future when the record of the past is so stark. And that record of only 23 denials out of 1,300 applications indicates to me that the kind of improved procedures called for in abandonment cases by this pending legislation are in fact needed.

Mrs. **Gradison**. Senator, those are not improved procedures. Those will cause many more time delays for the shipper and for the carrier. They will be very expensive. I am not sure that they can even physically be implemented in the manner in which the statute seems to contemplate.

Senator **Gore**. What is wrong with a hearing to allow consideration of the effect of the abandonment on the communities that are affected by it?

Mrs. **Gradison**. Well, generally, we sometimes send teams when there are abandonments contemplated and there are protests. We sometimes send teams from our special counsel's office to review those when they are requested.

Senator **Gore**. What would happen if that was shifted to the Department of Transportation? Do you think the Department of Transportation would have hearings and send teams and handle it that way?

Mrs. **Gradison**. I would assume that if they have a statute to work from, they are responsible to implement it.

Senator **Gore**. With the budget cuts and reduced staff, do you really believe the Department of Transportation is going to carry out those functions?

Mrs. **Gradison**. It is my anticipation that they would; yes.

Senator **Gore**. Well, it would not be mine. But I appreciate your responses.

Senator **Packwood**. Senator Pressler.

Senator **Pressler**. Mr. Chairman, I observed the interest in this subject. I think we have almost the full committee here and I see four or five former Members of Congress in the audience. I do not think we have had such attendance since the recording industry hearing when the stars were here.

So I think it shows how important this is considered. Let me join with Senator Gorton and Senator Gore in expressing concern about the boxcar problem.

In my own State, we are finding that short line and regional railroads are replacing or will be replacing some of our traditional lines. The Commission's adoption of any changes in the car hire rules for boxcars and other types of freight cars would have a devastating effect on short line operations in my State. For example, Dakota Rail is a class III railroad running from Millbank to Sisseton, SD. This short line railroad serves five shippers located in the northeastern part of the State.

Now, as I understand it, the changes in the car hire rules, without the small railroad protections contained in the Conrail short line compromise, could drive Dakota Rail out of business and leave the shippers without a competitive mode of transportation. Are you aware of the difficulties some of our short line operators would have because of this?

Mrs. **Gradison**. Yes, sir; we are aware of it. If you have a question, the answer is that it is in the large carriers' interest to work with these new short line carriers. It is in their interest because the short line carriers provide traffic and, therefore, revenues to the large carriers. So we anticipate the larger carriers being able to work out these differences with the short line carriers because it is in both of their interests.

Senator **Pressler**. Of course, a lot of the regional and short line carriers are helpless. You can set two people down in a room and tell them to work out their problems but if one of them is much more powerful and much bigger, then the big can just say "we are sorry we cannot help out." The point is that some of the smaller operators have no bargaining power.

I do hope you will look at the particular problems of Dakota Rail because I think it is illustrative of short line railroads across the country.

I have asked our chairman if we could have hearings sometime on the issue of short line and regional railroads because they are becoming such an important part of our rail transportation system. Let me say I am one who feels there have been a lot of losers in my part of the country over Staggers, but that is over and done with and I do not think we are going to be able to change that. So we are trying to go forward, and the regional and short line railroad approach appears to be our best solution in terms of moving grain, machinery, timber, and the other products in and out of my State.

But I would like to ask you to take a particular look at the case of Dakota Rail because I think it illustrates the boxcar/hopper car problem as it affects short line railroads. I would like a response from you on that for the record. I realize it would be impossible for you to respond here.

Mrs. **Gradison**. I would be happy to.

Senator **Pressler**. Let me also say that, as one who originally voted against Staggers, I find myself in somewhat of a peculiar situation today. I agree that it would be a mistake to go back to pre-Staggers regulation standards. Most of the harm that has been done to rural States as a result of rail derergulation has already taken place, I hope. And let me say that I concur with Senator Gore's statement. There have been winners and losers in the abandonment process. We hear more about the winners, but there have been a lot more losers who have lost badly.

I do not know if we are going to be able to legislate that or correct it but we have to go forward as best we can. Indeed, as I stated earlier there has been hope for the rural States through the recent increase of short line and regional railroads. That seems to be our best hope.

We today are undergoing that process in South Dakota, as well as many other parts of the Midwest. For example, we have entrepreneurs such as Jerry Ross of Dakota Rail who has done a great deal to get a short line railroad going and to work with it. He has worked miracles in our State and we are fortunate to have him.

There were many good aspects of Staggers and in some areas it has been effective in reviving the rail industry in my view. But since enactment of Staggers, the number of large railroads has continued to decline. Mergers proliferate. The big are getting bigger, and the small are getting worried. As the giants increase in size and decrease in number, a handful of railroads are controlling the great majority of rail traffic.

True, there are efficiencies to be realized through mergers, but they will not always be passed on if we allow competition to be eliminated along the way. To me, this rapidly increasing consolidation is a very worrisome trend.

Now, would you not agree—and I know you are in favor of abolishing the ICC or moving its functions to DOT—that the short line railroads are going to need some protection or some review in terms of their overall relationships with the larger railroads?

Mrs. **Gradison**. Yes. My position is the same as I have stated; that I believe that the rail oversight functions of the ICC must be continued, and that is up to you, the Congress, where those oversight functions are continued, whether it is at DOT, ICC, or Justice. It is up to you.

But I do agree that they must be continued.

Senator **Pressler**. Now, the proposed sale of Conrail to Norfolk Southern is a good example of what I am talking about. Today, Conrail and Norfolk Southern compete for east coast traffic. Merged, they would control it. The combination would create the largest single rail monopoly in our country's history. I do not like it because, once again, it spells trouble for my part of the country.

We have lived through the total collapse of the Rock Island. We have lived through the bankruptcy of the Milwaukee. We have lived through the bad aspects of Staggers. And so the picture in our part of the country is not all that rosy.

The Chicago & North Western provides much of the service in my State and is in the process of considering a sale to short line rairoads. The Chicago & North Western in particular would be hard hit by a Conrail/Norfolk Southern merger.

If we add a Conrail/Norfolk Southern on top of all that we have been through, the Federal Government could have a new ward to care for. The reason this type of merger will do so much violence to the Midwest is that a merged system will control virtually all rail traffic originating or terminating throughout the east coast.

Mr. Chairman, I have two or three other questions here, springing from my statement. I ask unanimous consent to submit questions for the record, and also to submit a statement on the boxcar problem and requesting a specific response, using Dakota Rail as an example.

Senator **Packwood**. Without objection.

[The following information was subsequently received for the record:]

Based on a staff conversation with Mr. Jerry Ross of Dakota Rail, it appears that his concerns are in two areas: boxcar car hire charges; and covered hopper car hire charges. He believes that, if car hire is deregulated, larger, connecting carriers will not permit short lines adequate car hire compensation for their cars and will charge the short lines excessive rental on foreign cars.

Car hire, as it affects short lines, is an issue in two pending cases—Ex Parte No. 346 (Sub-No. 19), relevant to boxcar car hire, and Ex Parte No. 334 (Sub-No. 6), relevant to car hire for all other equipment, including railroad-owned covered hoppers. The concerns raised by Mr. Ross are not unique to Dakota Rail; parties have raised short line issues in both proceedings.

The Commission recognizes the value of short line railroads to their shippers and to the national transportation system generally. Any decisions we issue in these two cases will address the impact on short line carriers.

Senator **Packwood**. Senator Kassebaum.

Senator **Kassebaum**. Thank you, Mr. Chairman.

Madam Chairman, I feel somewhat like the same song, second verse, when I get into my concerns about contract disclosure which I have raised on and off for several years. However, one of my real disappointments with the implementation of the Staggers Act has been the lack of understanding on the part of the ICC in interpreting the statutory term of "essential terms" regarding railroad contracts.

When Staggers was passed, I am sure that perhaps we assumed that it would be interpreted in its fullest sense and designed for the intent of protecting small shippers against unreasonable discrimination. But maybe we were too naive in assuming that common sense would prevail and how this would be interpreted. And I would just like to review for a moment what a contract summary is and why I think that it simply does nothing to enable a small agricultural shipper in Kansas, for instance, or any small shipper who cannot enjoy the full benefits of favorable contracts, to determine whether these contracts affect his whole livelihood in the matter.

For instance, a typical contract includes one, the name of the carrier; two, the commodity defined simply in the broadest terms such as corn or wheat or sorghum; three, the origin station, usually defined as broadly as all stations in one or more States. It does not include the name of the shipper, the specific origin or origins of the shipment, the contract rate, or the intermediate or transit points of the shipment.

My first question to you would be how can a shipper determine among the thousands of contract summaries filed each year, which one might affect him? And how can a shipper utilize the remedial measures specifically and explicitly stated in the Staggers Act?

Mrs. **Gradison**. Senator, let me first of all express that I share your concern with the amount of time it has taken to get the contract disclosure rules in place and to state that we do have interim rules in place. But with regard to the specifics of the question, I would like to turn to Jane Mackall. She can address the issue for you.

Ms. **Mackall**. Our interim rules require a potential complainant to come in and make a certain showing before it obtains access to the contract. In that way, we can look and not disclose confidential terms until it is clear that the person who is complaining would be affected by the contract.

Senator **Kassebaum**. I understand that. But how they even come in. As I just pointed out, all the information that they even have access to is so vague, how would they really know in what way they are being affected in order to come to bring a complaint?

Ms. **Mackall**. If it is possible that they could be affected, they come to the Commission and say here is our situation; we would like access.

Now the National Grain and Feed Agreement that we have under review now provides more information. It does not provide all of that information. It does not identify the shipper, for example.

Senator KASSEBAUM. Well, let me ask you specifically, and I know probably you are limited in what you can comment on, pending a docket case; however, under this compromise that has been worked out, could you explain what additional information would have to be disclosed in a typical contract summary? For instance, will a shipper still be allowed to state origin points as all stations in Kansas, Nebraska and Colorado?

Ms. MACKALL. No.

Senator KASSEBAUM. It would have to be specific?

Ms. MACKALL. Yes.

Mrs. GRADISON. That is correct.

Senator KASSEBAUM. Those are all the questions I have right now, Mr. Chairman.

Senator PACKWOOD. You asked the one I was going to ask, Senator Kassebaum, on disclosure. So I will pass and move to Senator Rockefeller.

Senator ROCKEFELLER. Mr. Chairman, I will be brief in concluding because I know we have other witnesses, but I want to comment on a couple of things that have come up this morning.

The chairman of the full committee mentioned the fact, and I think this cannot be passed by, that rail rates have increased a relatively small amount. I think he said one-half of 1 percent or something of that sort.

Of course, when you are talking about revenue adequacy or profits or what a rail rate does mean, you also have to know what it means in terms of the cost to the railroad. What has not been talked about is the cost; what has happened to the cost to the railroads in consequence of or in relationships to the rates that they charge.

The point I would make, and I made this at a previous hearing, is that it is true that the general costs of railroads for coal, for example, have moved at a relatively constant level in relation to other commodities, but the cost to the railroad of moving coal has gone down because of the fact that the shippers have to bear so much of the cost.

And the difference between the cost to the railroad and the rates the railroad charge, whether they have gone up or not, is the profit. And the profit is what we are talking about when we get into the subject of revenue adequacy and other subjects.

I felt I needed to make that point.

From that, let me ask you about the rail cost adjustment factor. That is a key issue. Where does the ICC get the information and the numbers that make up the rail cost adjustment factor? Can you answer that?

Mrs. GRADISON. Yes, sir. That data is supplied by the AAR.

Senator ROCKEFELLER. By the railroads?

Mrs. GRADISON. Well, that is true. They do submit their information and it is calculated by their association.

Senator ROCKEFELLER. I am not arguing. I was just making sure.

Mrs. GRADISON. That is correct.

Senator ROCKEFELLER. Let me give you an example. In December 1985, the AAR, the railroads provided the ICC with the data to make an upward adjustment—this is December of last year, mind you—an upward adjustment in fuel cost of almost 5 percent for the first quarter of this year, despite what has to be one of the more stunningly obvious facts of life in the world today, that the cost of fuel oil at least is going way down, disappearing out of sight.

Now, at the time, the Edison Electric Institute filed an objection to the railroad numbers. Did they have a right to do so? Evidently they did not. They were not given standing; they were not allowed to object by the ICC. And I think that in a time of declining prices when you are talking about rail cost, and they are asking for a rate increase because of fuel cost, and the EEI, the electric utilities, cannot come in and even argue, it brings out what I think is the overall problem which is whether the shippers and the railroads approach the table, so to speak, with the ICC with equal bargaining power.

And I would suspect that Senator Long and Congressman Harley O. Staggers, Sr. from West Virginia, when they helped to create this act, had in mind that railroads and shippers would come to the table with something resembling equal standing.

I just do not believe that this is the case, and I just do not believe that the ICC has treated the act with anything near equity at all.

My final comment, I guess, would be to ask you why is it—we agree that the railroads are doing extremely well. And do we ever agree with that. With Piedmont Airlines, North American Van Lines, the American Barge Line, the railroads have just about everything they need, and now we are going to perhaps—hopefully not—but perhaps give Conrail to Norfolk Southern. So in our part of the country, rather than three railroads, we will have two.

The coal industry is flat on its back. Half the coal miners in my State of West Virginia and Wendell Ford's State of Kentucky are out of work. There is no light at the end of this tunnel for the coal industry.

Why is it that Senators and Congressmen, coal operators, public officials and Governors from coal States, and utilities, are so unanimously concerned, so unanimously convinced that they are getting a bum shake from the ICC?

I mean, are we fabricating something? Are we doing this so that we can get our names in the newspaper? Or are we trying to reflect a genuine concern?

You say: "Give us time." You also say that the ICC ought to go and its functions placed in the Department of Transportation where there would not even be a stand-alone agency. Now, why are we concerned? Is it because it is a habit that we have on a quadrennial basis, or because coal is getting ruined in part by the cost of transporting it by rail, with which the Japanese, the folks in this country, everybody seems to agree. Are we so wrong?

Mrs. **Gradison**. I think it reflects a sincere concern.

Senator **Rockefeller**. Ill-founded but sincere?

Mrs. **Gradison**. No. In all cases it is not ill-founded. It has taken us a long time to put the coal rate guidelines in place. As I referred to earlier, I have a list of all of the attempts that the Commission had made to come up with the existing coal rate guidelines that we are confident are going to work.

With regard to the transfer of the agency to the DOT to provide those functions. The law is the law. If it is implemented at the ICC or the DOT, you all spell it out and it is our job to interpret it and to implement it, and we are going to do the best that we can.

We have heard you. With this CURE bill we have attempted to be responsive. There are many elements in the CURE bill that we at the ICC have attempted to address through our actions in the last 6 months. You have been successful in having your voices heard by the ICC, and we are now articulating that we have heard you.

I must say that the legislation that we are reviewing today would be much more cumbersome than any gyrations we have been accused of going through. The legislation that is under review today would be much more expensive for your shippers, much more expensive for the carriers, and much more expensive for the American taxpayer. That summarizes my concerns.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Senator PACKWOOD. Senator Long.

Senator LONG. Let me just ask you one thing, Madam Chairman. When you are looking at a rate, is it fair to put the burden on the shipper when the railroad has all the information? They have all the records, all the cost studies and all the rest of it. The captive shipper has none of that.

Now, would it be more appropriate that the burden of proving the reasonableness of that rate be on the railroad, that has all of the information, rather than on the captive shipper, who does not have it?

Mrs. GRADISON. We have attempted to address the burden of proof in a number of the proceedings that were before us this fall, and it does cover that but not in total.

Perhaps Jane can respond in a better way than I can on this. Jane.

Ms. MACKALL. It is a principle of law generally that the party seeking particular relief has the burden of proof. Now, that does not mean that they have to create every piece of data. Discovery is available, and discovery is being granted to complainant so that they can go into the railroad files and get the information they need to make their case.

Senator LONG. We have the opportunity to put the burden of proof wherever we want to, and you do, too, assuming that we choose to act or you choose to act. I would just ask you the question of fairness.

When the railroad has all the information in its files and the other fellow does not—that little shipper does not have all the information about the railroad's cost—why should we not put the burden on the railroad to prove the reasonableness of its rates rather than on the captive shipper, who has no information?

Ms. MACKALL. It is your choice, Senator.

Senator LONG. Thank you. That is all. Thanks.

Senator PACKWOOD. Senator Ford.

Senator FORD. Just one question. Madam Chairman, how long have you been on the Commission?

Mrs. **Gradison**. Since June 1982. As Congressman Tauzin said, the Commission has a new chairman but they do not have a new commissioner, and I think——

Senator **Ford**. All I wanted to know was the amount of time you have been on.

Mrs. **Gradison**. Since June 1982.

Senator **Ford**. During that time—and I am just reaching here now—during that time when you have had a split Commission on a vote, say whatever it might have been, and those who lost with the minority vote have taken it to court, how many have been found for the minority vote on the Commission. How many times has the majority on the Commission been reversed?

Mrs. **Gradison**. I do not have those numbers.

Senator **Ford**. Have there been any?

Mrs. **Gradison**. Yes, sir.

Senator **Ford**. There have been several, is that right?

Mrs. **Gradison**. There have been a few. I would say the vast majority have been in the other direction, that when I vote with the majority we have been upheld by the courts. I would say 98 percent of the cases that I vote on stand that way. I have lost some, yes, sir.

Senator **Ford**. Only 2 percent?

Mrs. **Gradison**. Two percent is probably a higher number than it really is. Probably one-half of 1 percent of the cases in which I was in the majority that were taken to court that we then received back from the court.

Senator **Ford**. Were those cases taken to court found for the carrier or for the shipper?

Mrs. **Gradison**. I am sorry?

Senator **Ford**. If you make a decision on the Commission and it is then taken to court, is it taken to court by the shipper or by the carrier?

Mrs. **Gradison**. Sometimes both.

Senator **Ford**. Give me some——

Mrs. **Gradison**. I am sorry. I do not have an analysis of my voting record.

Senator **Ford**. I am not asking about your voting record. I am not worried about how you voted. I am not asking that.

I am just asking about the majority of the Commission. You have a reduced Commission now, and I just wonder how many times, when the Commission makes its decision, does it go to court and who takes it to court? Is it the shipper, or is it the carrier?

Mrs. **Gradison**. It has been our experience that both of them do. Nobody is happy.

Senator **Ford**. You were pretty good at 98 percent and 2 percent a moment ago. Give me a percentage concerning who takes cases to court.

Mrs. **Gradison**. I cannot answer your question.

Senator **Ford**. Could you supply that for the record?

Mrs. **Gradison**. Yes, sir.

[The following information was subsequently received for the record:]

From June of 1982 through January of 1986, there have been a total of 366 petitions for review of Commission decisions involving railroad matters. In a number of instances, multiple petitions for review were filed by a number of parties challenging a single Commission decision—a fact that inflates the over-all statistics. The total number of 366 includes petitions for review of rate, entry, exit, mergers and competitive access cases, plus rulemakings of the Commission that affect the resolution of such disputes or exempt carriers from the laws regulating those areas of activity.

A breakdown of the 366 cases shows that 75 were brought by railroads, 132 were brought by shippers, and 159 were brought by other parties. These "other" parties comprise a broad spectrum of States and their regulatory agencies, labor unions, water and motor carriers, stock holders, land owners, municipalities, etc.

Focusing on rate matters (individual rate disputes and rulemakings that affect them), 30 cases were brought by railroads, 122 were brought by shippers, and 68 were brought by other parties.

Senator **Ford**. Thank you, Mr. Chairman.

Senator **Packwood**. Senator Kassebaum.

Senator **Kassebaum**. Yes, Mr. Chairman. I would just like to follow on with a question I asked before about the specific description of destination and origin, because I was surprised when you said, yes, that it was included. What the National Grain & Feed Association agreement says, and I think this is the catch, is that broad geographic descriptions such as stations in Illinois shall not be employed except to the extent that these terms actually are used in the contract. Now, would you not think that perhaps that would be one way to circumvent this, by actually writing it in that broad way in the contract?

Ms. **Mackall**. The contract has to be specific enough so that the shipper and the carrier know what it applies to. I would expect that it would never be that broad because the shipper and carrier have to know in the contract exactly what points are involved. Saying "the State of Illinois" does not satisfy this requirement.

Senator **Kassebaum**. I just have a feeling that there will be some very clever attorneys engaged to figure a way to get around it, because the same applies to this specific commodity designation as a generic description.

Ms. **Mackall**. As the Chairman said, this proposal will be going out for comment, and I am sure those concerns will be raised in the comments and the Commission will consider them.

Senator **Kassebaum**. I hope so, because it seems to me we need to get out more information than is currently available, and I have a hard time understanding that this would put any real restraints on the ability of shippers and railroads to enter into contract negotiations.

Thank you, Mr. Chairman.

Senator **Packwood**. Senator Rockefeller.

Senator **Rockefeller**. Thank you, Mr. Chairman. Just one question.

Do coal rate guidelines apply to export coal?

Ms. **Gradison**. Yes, sir; export coal is now completely regulated, 100 percent regulated, and the guidelines that affect domestic coal would also affect export coal.

Senator **Rockefeller**. Do you believe that the export coal should be exempted from regulation?

Mrs. **Gradison**. I voted in favor of exempting export coal from regulation, and the courts found that we did not have the authority to do that. They sent it back to us, and yes, sir, that is a case that I did vote on.

Senator **Rockefeller**. Madam Chairman, you are quite correct. You did vote for the exemption.

With respect to the whole question of exporting coal, which is critical to my State of West Virginia, I would just pose this question. Since you voted to exempt exported coal, why should I have confidence that you, as Chairman, would take any action to reduce coal export rates so long as the ICC exists?

Mrs. **Gradison**. We lost in court. The court sent it back to us. I have a statute to interpret and implement. The court's interpretation of that statute says we cannot do it; therefore, my responsibility in my future interpretations is to consider what the court has told us and apply that to future cases.

Senator **Rockefeller**. Thank you. Thank you, Mr. Chairman.

Senator **Packwood**. Any other questions?

[No response.]

Senator **Packwood**. If not, thank you very much.

[The statement follows:]

STATEMENT OF HON. HEATHER J. GRADISON, CHAIRMAN, INTERSTATE COMMERCE COMMISSION

Mr. Chairman and members of the subcommittee: I want to thank you for this opportunity to present the views of the Commission on S. 477, the "Consumer Rail Equity Act," which is a bill intended to enhance rail competition and to ensure reasonable rail rates where there is an absence of effective competition.

The Commission believes the proposed legislation will increase regulatory cost and burden without commensurate improvement in the delivery of rail services, and, taken as a whole, that the bill would diminish the likelihood of continued improvement in the productivity, efficiency and financial soundness of the rail system. We have testified to our belief that the Staggers Act is functioning well. We have sought to adjust our initial implementation rules where developments have shown that they were not working satisfactorily. This is a continuing process, and the Commission has further refinements under active consideration. From our perspective, five years is not sufficient time to judge the outcome of the Staggers Act. The deterioration of the railroad sector was a long, drawn out process. Its revival is proceeding more rapidly, but we think it would be unwise to assume that it has been accomplished permanently. It is unnecessary to introduce new risks and additional regulatory oversight at this time.

The Commission does, however, recognize that the provisions in the bill reflect sincere criticisms of the initial implementation of Staggers. On some issues, the Commission has already responded with revised policies, reflecting wherever possible negotiated reconciliations among disputants. We have other initiatives under active consideration, particularly in the area of revenue adequacy. But we also believe that some criticism directed at the Commission arises out of misunderstanding, and that the proper response is to let actual experience displace anticipatory fears. Nowhere is this more appropriate than in the determination of maximum coal rates, where we firmly believe that our standards do what the Staggers Act intended, and that experience with implementation will bear us out.

Since the principal reason for testimony this morning is to consider the provisions of S. 477, I will turn to a discussion of that bill. But I will return to some of the Commission's recent and anticipated actions where the context warrants.

MARKET DOMINANCE

The substantive amendments proposed by S. 477 begin with Section 3, revisions to market dominance standards. The Commission recently changed its own standards in response to an agreement reached by the Association of American Railroads, the National Industrial Traffic League, and other shippers. S. 477 proposes statutory ratification of these new standards to the extent it (1) shifts the burden of proof to the railroads on issues of product and geographic competition, and (2) establishes the proposition that effective competition at a destination establishes no presumption regarding competition at the origin and vice versa. Since these matters reflect current policy, legislative action is not required.

S. 477 would also preclude the use of source (geographic) competition at a destination as evidence that rates might be restrained at origin. This issue was argued to the Commission during its reconsideration of the market dominance guidelines but rejected. The Chemical Manufacturers Association, chief proponent of this viewpoint, argued in essence that only the final price at the destination would be constrained. Any advantage that a producer had over its rivals' costs might no longer accrue entirely to the benefit of the producer, but might be appropriated by the rail carrier instead. While from the private sector standpoint, such an argument over the division of rents is understandable, the Commission believed that public policy was best pursued by allowing a more flexible approach than CMA requested. Consequently, the Commission rules allow the consideration of destination competition, but provide that its mere existence is insufficient evidence of the absence of market dominance. This puts the burden on the railroads to show that it is an effective restraint on rates.

RATE REASONABLENESS

Section 4 of the bill places the burden of proof on the railroads in all rate reasonableness cases and prohibits use of the Commission's coal rate guidelines [1] as a standard for maximum rate reasonableness. Instead, the bill would require that the Commission undertake a new rulemaking proceeding, to be completed within one year, establishing maximum rate standards for all captive commodities. Specific findings would be required in every rate case on a number of factors relating to the carrier's revenue adequacy, rate/cost relationship, and the Long-Cannon factors of 49 U.S.C. 10707a(e)(2)(C). In addition, consideration of stand-alone costs is specifically prohibited.

Burden of proof issues are admittedly difficult because what is typically at stake is not simply who has to carry the weight of logic, but who has to carry the weight of expense. Because railroad rate cases can become hypertechnical, this issue of expense is a serious problem for smaller shippers. I have directed staff to produce a notice of proposed rules addressing this problem, as well as the issue of non-coal standards. I expect that these matters will be presented to the Commission shortly.

Beyond the issue of litigation expense, however, the Staggers Act apportioned the burden of proof in a manner that I believe is consistent with rational regulation. In many cases that means that shippers have the burden of establishing that a challenge to a rate is substantive, but it also means that, in the most suspect cases, the burden is placed on the railroad. Eliminating these presumptions as the proposed bill would do, is at odds with the reality that the great preponderance of rail traffic is subject to competitive pressure, a reality correctly recognized by Congress in 1980.

Proposed section 10701a(b)(3) is a nearly complete repudiation of the Commission's approach to maximum coal rates. As noted above, we believe that this reaction is a prejudgment of the Ex Parte No. 347 (Sub-No. 1) standards that will not be borne out by experience. The revisions seem to call into question the issue of whether adequate revenues are required at all, a question which is only pertinent to portions of the system that are marked for abandonment. The section also suggests that a logical cap to price differentials might be the "average" rate established by the cost recovery percentage, but by definition capping rates at the average will mean less than full returns, since some rates will remain below average due to competitive circumstances.

The proposed revisions also instruct the Commission to consider the relationship of the rate to cost of service. Making the assumption that "cost" as so used is defined by arbitrary accounting conventions, this section invites a return to problems that plagued the industry for years. The Commission and the courts have rejected most strict cost or other arbitrary constant cost allocations as unworkable or unsupportable. Railroads are not, for competitive reasons, able to obtain average fixed cost allocations from large segments of their traffic. A fundamental tenet of the Commission's Ex Parte No. 347 (Sub-No. 1) guidelines is that most fixed or common costs cannot be reasonably allocated to traffic according to a set formula and that prior attempts to do so have been unproductive if not harmful. As the Commission explained in its decision: Because competition compels the railroads to price some of their services below an arbitrarily assigned "cost," they must be able to price other services above their assigned "cost" in order to compensate. Otherwise, the carriers may never be able to cover all their costs and earn adequate revenues.[2]

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[1] In Ex Parte No. 347 (Sub-No.1), *Coal Rate Guidelines*, served September 3, 1985, the Commission adopted "Constrained Market Pricing" guidelines for determining the maximum reasonable rate level that railroads may charge for the transportation of "captive" coal traffic.

[2] Ex Parte No. 347 (Sub-No. 1), *supra*, at p. 4.

The Constrained Market Pricing approach adopted by the Commission in that decision proceeds from the premise that "costs" (at least fixed or common costs) are most efficiently and successfully allocated in accordance with demand, not accounting criteria. It is the best methodology that the Commission has evaluated for establishing rate reasonableness and, at least preliminarily, the Commission's approach has been sustained by the courts.

While the Commission has, after several difficult years of trial and error[3], reached a rationally defined policy based on demand, demand is not left unrestrained. However, the proposed bill would eliminate what we believe is the most effective restraint on railroad pricing. The use of this restraint (stand-alone cost) guarantees that prices will not rise above the competitive entry level. Without this guarantee, the remaining analysis could result in unacceptably high rates.

Finally, the revised bill stresses the importance of the Long-Cannon criteria for maximum ratemaking. We agree with this emphasis, and have designed our Ex Parte 347 (Sub-No. 1) rules to permit this issue to be approached from two separate directions. Long-Cannon, like rate reasonableness generally, does raise the question of the expense borne by small shippers, and I have asked that this issue be considered in the context of the rulemaking for non-coal maxima mentioned above.

RAILROAD TRANSPORTATION POLICY

Section 5 of the bill amends the rail transportation policy of 49 U.S.C. §10101a in two respects. It eliminates reference to revenue need in subsection 10101a(6), and adds a new subsection (15) to encourage and promote competitive transportation rates for domestically produced coal and other commodities in order to increase their competitive position in both import and export markets.

The first change is unobjectionable and reflects current ICC policy. As enacted, 10101a(6) could be interpreted to permit rates to rise to any level, as long as overall revenue inadequacy obtained. However, we interpret it to mean that individual rates must be reasonable, and that revenue inadequacy does not sanction inefficient pricing.

Encouraging and promoting competitive rates for domestic energy supplies and other products and commodities is not inconsistent with current policy, at least at first reading. But it is not clear from the bill what is meant by "competitive rates" and there may be some problems in applying the term. For example, if rates are limited to those existing under a highly competitive environment, the provision would result in a loss of the ability to price services according to demand. Carriers would not then be likely to recover fully joint and common costs.

INFLATION BASED RATE ADJUSTMENTS

The Commission is required under the Staggers Act to publish a quarterly Rail Cost Adjustment Factor (RCAF). This index was mandated to eliminate regulatory interference in rate increases designed solely to recover inflation. The RCAF is based on the ratio of current costs to the fourth quarter costs of a legislatively-prescribed base year. The numerator is the latest published index of railroad costs, compiled or verified by the Commission. It must reflect "the changing composition of rail costs, including the quality and mix of material and labor." Section 6 of the proposed bill would expand the numerator to include "changes in railroad productivity, volume, and output mix" as well.

The bill would also require that, when the RCAF declines, rail rates that formerly were increased through the application of the RCAF be reduced to reflect the lower costs. RCAF rate reductions would not be considered a maximum rate prescription nor would implementation of other individual rate increases be precluded.

The Commission is currently considering the feasibility of adding productivity to the RCAF formula.[4] A number of ways to do this have been suggested by the parties to the proceeding. The questions now before the Commission are: (1) whether a methodology exists to do this accurately; and (2) if so, whether the benefit will exceed the cost. Given these important concerns, we believe it more appropriate to defer legislative action. The answers to these questions will give Congress a better idea as to whether it wishes to proceed with this proposal.

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[3] The requirement contained in subsection (c) of section 4, that the Commission produce a new maximum rate policy within 360 days, may seem achievable in the abstract. In reality, if the Commission is denied the use of the competitive entry (stand-alone) constraint, there is little likelihood that a judicially sustainable rule could be achieved in that time frame.

[4] Ex Parte No. 290 (Sub-No. 4), Railroad Cost Recovery Procedures—Productivity Adjustment.

The issue of rate reductions is one the Commission has addressed. We have been hesitant, for a number of reasons, to order reductions when the index declines. Under law, we cannot order reductions for commodities over which we lack jurisdiction (e.g., where the revenue to variable cost ratios of the rates are below 180 percent). Thus, the reductions could only be required for "captive" traffic. There are also practical problems. It may not be possible to determine what amount of reduction would equalize costs and revenues. Also, any across-the-board rate reduction requirement would not reflect market place considerations (such as are currently taken into account by carriers through exceptions or holddowns of the authorized increase).

The Commission believes that, while the current system is not perfect, the problems of rate reductions we have discussed outweigh any minimal, short-term rate relief shippers would obtain. Under the present system, declines in, for example, one quarter are factored into future quarterly indices. Thus, when an increase might be justified based on the most recent quarter's results, the fact of an earlier decline in the index results in either a decision not to authorize a rate increase or authorization of the lesser amount.

STANDARDS AND PROCEDURES FOR DETERMINING REVENUE ADEQUACY

The Commission appreciates and shares the concerns expressed over its existing revenue adequacy determinations. We also appreciate that the provisions now before this Committee have been revised, and that the most important facet of our existing rules—reliance on the cost of attracting new investment—would be retained as the standard for determining revenue adequacy. This is consistent with the direction taken in the Staggers Act.

However, S. 477 proposes several methodological changes in the calculation of revenue adequacy under the cost-of-capital standard. Taken as a whole, these changes would be likely to lower the threshold of earnings at which any particular railroad would be considered revenue adequate. That in turn would mean, for a revenue-adequate railroad, a certain loss of pricing flexibility, particularly the right to take increases under 49 U.S.C. 10707a(d). (Reference here is to the inflation-plus-4% provision enacted in Staggers as part of the Zone of Rail Carrier Rate Flexibility.) In addition, in a contested maximum rate case, the revenue-adequate carrier would lose whatever advantage is considered to spring from 49 U.S.C. 10701, the Staggers Act section entitled "Standards for Rates for Rail Carriers," that includes language directing that the Commission shall recognize the policy that railroads shall earn adequate revenues.[5] From the Commission's perspective, we are uncertain that much is achieved in this fashion. Little use has been made of the 4 percent provision, and the Commission's maximum coal rate policies, aimed as they are at ensuring efficient rates, do not permit rate increases based solely on overall revenue inadequacy. We would also note that, under rules adopted in Ex Parte No. 445 (Sub-No.1), the Commission will not consider revenue inadequacy as a justification for anticompetitive actions in competitive access proceedings.

At the same time though, we agree that our existing standards and procedures for determining revenue adequacy are not producing a realistic picture of the financial condition of the rail industry. The Commission's most recent revenue adequacy determination finds that in 1984 no railroad was revenue adequate. In fact, comparison of our revenue adequacy determinations for each of the five years from 1980 through 1984 shows a decline in the economic health of most of the major carriers, and only a minor improvement for others. This is directly contrary to the general perception, shared by the government, the rail industry, the shipping public, and the investment community, that the financial condition of the railroads has improved substantially since passage of the Staggers Act. We have therefore concluded that our present standards, including our past decision not to consider multiple financial indicators must be reassessed.

For the foregoing reasons our Bureau of Accounts has been directed to prepare an options paper covering all of the relevant issues and areas of controversy for submission to the Commission no later than the first week of April 1986. Following voting on the various options, the results would be incorporated in a revised decision in the pending Ex Parte 393 (Sub-No. 1) proceeding.

This is not to say that the changes proposed in S. 477 are without merit. Several proposals are similar to items that the Commission is itself considering. However, we do believe that there is an important difference between administrative refinement and new legislation. The latter is much more likely to be viewed with alarm by the investment community and, if the favorable climate achieved by the Staggers Act is destroyed, capital costs may rise, forestalling new efficiency-producing investments. We therefore recommend that the revenue adequacy question be addressed through the administrative process rather than through legislation.

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[5] This provision would itself be eliminated by changes made elsewhere in S. 477.

Beyond these general observations, specific proposals in the bill are discussed below.

(1) Proposed subsection 10704(a)(3)(A) would require the identification of revenues, expenses and investment base reasonably related to providing rail service, and, similarly, subsection (B) indicates that the investment base should include only those assets reasonably related to providing rail services. The Commission agrees in principle with these directives. In Ex Parte 393 (Sub-No. 1), the Commission has proposed methodological changes which will better reflect rail investment, expense and income. There is, however, the possibility that the proposed bill contemplates measures far more extreme than the Commission has under consideration. We would be particularly concerned if the emphasis on "used and useful" were to become a factor in abandonment decisions. There has been a very significant reduction in rail plant over the past five years, a reflection of the competitive pressures on rail carriers and the expedited abandonment procedures introduced by the Staggers Act. The Commission has relied on the market to bring this reduction about, and we would infer from the abandonment provisions contained elsewhere in the S. 477 that this process is moving as rapidly, perhaps even more rapidly, than Congress anticipated in 1980. We would be particularly concerned if a new emphasis on defining "used and useful" were to accelerate the abandonment of lines.

(2) Proposed subsection 10704(a)(3)(B) indicates that revenue adequacy should be calculated using straight-line depreciation over the economic life of assets, less deferred taxes from accelerated depreciation, and that assets should be valued at original cost. The Commission's existing standards are based on straight-line depreciation. However, tax regulations and the Economic Recovery Tax Act of 1981 (ERTA) contain several provisions which have given rise to large deferred tax reserves. The Commission's initial view was that failure to recognize these gains as part of the revenue adequacy determination would deprive the railroads of the benefits intended by tax law. Stated differently, if the benefits of accelerated income were to have been passed through to rate levels, the investment incentives of ERTA would have been converted to consumption incentives. We do recognize, however, that ERTA has created a surge in capital available for investment at very low cost. The Commission has directed its Bureau of Accounts to recommend options for revising the treatment of deferred taxes. One methodology under consideration would, in effect, treat deferred taxes as a component of the capital structure at their embedded cost level, which is zero. While this approach is not the same as excluding deferred taxes from the investment base its impact is similar and it has the advantage that, as deferred tax reserves are depleted over time, the cost of capital is automatically brought back to market levels.

(3) Subsection 10704(a)(3)(C) indicates that the cost of capital shall be determined using the actual cost of debt capital and the current cost of equity capital, which current cost should take into consideration bond ratings, fixed charge coverage, return on shareholder's equity, and the reasonableness of debt equity ratios. As to the proposals for costing equity capital, we do not understand the bill to require a substantial deviation from current practice. We do not interpret the parenthetical reference to the reasonableness of debt ratios to require that the Commission specify the use of an optimum ratio.

The use of embedded debt is contrary to current policy. In the past, the Commission found that the current cost of debt capital is the correct choice for regulation in a system where returns to capital are not guaranteed. There have been repeated suggestions that, because electric utility regulation is typically based on embedded costs, the same should hold for rail regulation. This is difficult to reconcile with the fact that the typical utility is regulated under a standard which guarantees, assuming no untoward occurrences, that returns will be allowed for whatever new investments are permitted by the regulators. A captive customer base makes this guarantee realistic, and the historic results in the utility field permit investor confidence. The Commission is unable to guarantee any particular level of return, and, consequently, the issue in railroading is as much an issue of disinvestment as reinvestment. If the Commission, or the Congress, were to adopt a revenue adequacy standard that failed to recognize the competing alternatives for risk capital, and if that standard were to be seen as foreclosing the opportunity to earn the current cost of capital, it is hard to see why disinvestment would not result. We would note, however, that it is not entirely possible to predict whether a change to an embedded debt standard would be seen as a sufficient foreclosure of an opportunity for earnings consistent with current capital costs. As interest rates have declined dramatically in the past several years, the discrepancy between current costs and the embedded debt level has narrowed substantially.

At the same time, we recognize that the basic lag in cost-of-capital determinations under present methodology has resulted in the use of capital costs which are not reflective of current values. For example, the most recent cost of capital determination is based on debt and equity costs of 12.8 and 17.3 percent—values current in 1984. In the intervening period, debt and equity costs have gone down significantly. The use of current data would have reduced the present 15.8 percent target considerably. In the context of the 1985 cost of capital determination, the Commission will propose a method for using current values.

(4) The proposed amendments to subsection 10704(a)(4) would subject annual revenue adequacy determinations to notice and comment, and require that the first two Long-Cannon factors be taken into account, presumably to reflect the possibility of an "avoidable" shortfall that should not be recognized. This subsection also contemplates the submission of carrier data in addition to that already obtained by the Commission, and presumably this data would be directed in particular to the issues of "used and useful assets" and Long-Cannon efficiencies.

The notice and comment provision would add an appreciable amount of time and expense to revenue adequacy determinations, and would require a substantial addition to agency resources. This is particularly true if line-specific and commodity-specific data were required of all carriers. While the Commission hesitates, because of the enormous complexities involved, to state that such data is necessarily required by the bill's emphasis on "used and useful" criteria and the introduction of the Long-Cannon factors, it does appear that the bill contemplates informed public comment on these issues, which comment would in turn require an available data base. We do not believe that this kind of increased regulatory burden and oversight is likely to be warranted by any public gain. As noted, there are strong market incentives working to reduce uneconomic investment, and the Long-Cannon goals are recognized in individual rate investigations.

EXEMPTION AUTHORITY

Under Section 8 of the bill, if the statutory criteria of section 10505 are satisfied, granting an exemption would be discretionary rather than mandatory. In making the required statutory finding of whether continued regulation is necessary to protect against an abuse of market power, the Commission would have to consider not only whether shippers require protection, but also whether other persons require protection. Finally, any exemption would not be permitted without a prior determination that the carrier does not have market dominance over the transportation, unless no interested person has objected after a reasonable notice period.

The requirement that, before issuing an exemption a market dominance determination be made (unless no objection to the exemption has been filed after a notice period), raises a number of questions. First, while market dominance would only appear to be relevant to rate matters, the requirement for a market dominance determination is not on its face limited solely to rate matters. We have used the exemption authority expansively to reduce regulatory lag in cases where Commission approval is necessary for particular transactions, e.g., the issuance of securities or the acquisition of a rail line to continue service that would otherwise be abandoned. Thus, for example, a carrier's request for an exemption to issue securities would under the terms of the proposed language require a market dominance determination, notwithstanding the fact that market dominance would not even be an issue regarding a securities issuance. In addition, the proposed mandatory notice period would, in many instances, delay parties from consummating unobjectionable transactions quickly, thus imposing a new type of regulatory lag.

More importantly, even in cases where captivity is an issue, the bill would limit our discretion in two other ways. First, it would eliminate our ability to structure broad exemptions. While in significant exemption proceedings we have always used a notice and comment procedure, no record, no matter how extensive, can answer all questions or resolve all doubts regarding the degree of effective competition. Yet this is what the bill requires prior to exemption. Under its language, the TOFC/COFC exemption, which has been so successful, could not have occurred.

Second, the relationship of the market dominance finding to the existing requirement in section 10505(2)(B) relating to abuse of market power is unclear. Moreover, the bill would, in effect, eliminate use of the limited scope criterion of section 10505(a)(2)(A). For example, a minor exemption proposal that would satisfy the alternative limited scope requirement would still require a market dominance determination in the event of opposition. In the latter case, because there is no clearly stated distinction between market power and market dominance, the bill would appear to impose a process in which a market power determination may not be relevant, but a market dominance determination is nevertheless necessary.

Finally, we cannot ignore the costs the Commission would have to bear in publishing notice of each exemption request in the Federal Register.

ENHANCEMENT OF COMPETITION

Section 9 of the bill adds a new section 10705(g) to require all railroads to participate upon request in at least one "competitive" joint or proportional rate. It makes action under Sections 11103(a) and (c), pertaining to the use o terminal facilities, mandatory if the statutory criteria are met. Final action would be required 180 days after a petition is filed and an additional criterion, the "need for competitive rail service" is added to section 11103(a). Other changes include: compensation for joint use of terminals would be based on a cost-plus-return formula rather than current condemnation principles; addition of a compensation formula to section 11103(c); a limitation on consideration of competitive rail service in sections 11103(a) and (c) to direct rail competition; and prohibition of consideration of any railroad's revenue adequacy. A 45-day notice period on cancellation of reciprocal switching is imposed and suspension is mandatory if a shipper has or would use the service for a significant portion of rail transportation at the affected site.

The Commission, in Ex Parte No. 445 (Sub-No. 1), has recently adopted rules that address many of these competitive access issues. There are significant similarities between the Commission's new rules and the proposed bill, and there are also significant departures. The proposed bill would make joint rates and/or proportional rates mandatory. The level of proportional rates would be prescribed by statute in a manner which could severely constrain the ability to recover capital through differential pricing. The level of joint rates would apparently require some degree of identity to single-line rates without consideration of efficiencies and service differentials. Similar proposals were presented to the Commission in Ex Parte No. 445 (Sub-No. 1) and rejected. The Commission instead chose rules that related the joint rate issue to competition, much as an antitrust court might, but with significant added advantages for shippers. These rules were the product of negotiated compromise between many of the railroads and important shipper groups. It is our belief that deciding these issues according to competitive principles, including the emphasis on intramodal competition found in the present National Transportation Policy, is vastly preferable to the reintroduction of arbitrary rate equivalency rules.

In Ex Parte No. 445 (Sub-No. 1), the Commission also addressed the issue of reciprocal switching. Our new rules are again similar in some respects to those proposed by the bill. There is, for instance, common agreement that revenue adequacy and product competition should not be considerations in determining the need for reciprocal switching. But there are also differences. The principal differences relate to intermodal competition, and the prescription of a price cap for switching charges. The Commission's rules leave open the possibility of considering intermodal competition in assessing the need to prescribe agreements. The Commission has asked the Court of Appeals for a voluntary remand of a case in which this issue is prominent, with the intent to give the matter further analysis in the light of the shipper/railroad accommodation in Ex Parte No. 445 (Sub-No. 1). We believe that there is a good chance that the rules adopted in Ex Parte No. 445 (Sub-No. 1) will result in a satisfactory outcome, and that mandatory switching provisions are not required.

As to the provision for mandatory use of terminal facilities, the Commission would urge a large dose of caution. Rail revitalization has been accomplished through impressive reinvestment in plant, and a continuation of that trend is necessary for the future. While there have been instances where sharing of capital plant has clearly been a competitive necessity, these situations have always been the exception, becoming more so over time, as other forms of competition have eroded rail market power. To now introduce the possibility of widespread trackage rights and terminal rentals would be a step backward. It would not only jeopardize the efficiencies that arise out of differential pricing, as do the other provisions in Section 9, but mandatory terminal and trackage rights would directly and immediately threaten all new investment.

ABANDONMENT PROCEDURE

Section 10(a) of the bill amends 49 U.S.C. § 10904(a)(1) to include a new subparagraph (B) providing for a one-year moratorium on a railroad's ability to resubmit an abandonment request that has once been denied. Under this provision, a railroad could not file an application to abandon a line, or portion of a line of railroad, if within the year the Commission had issued an effective decision denying abandonment of part of the line. An exception is permitted if the railroad shows a substantial change in circumstances material to the abandonment.

By contrast, a carrier can today file an application any time after the issuance of the decision denying abandonment provided it first complies with the requisite notice requirements, including changes in its system diagram map.

We endorse this provision of the bill. We would only note that the bill does not differentiate between "denials" and "dismissals." We recommend that "denials" be defined as decisions on the merits. Dismissals are usually based on procedural flaws in the application and occur prior to any substantial expenditure of time or funds by protestants. In other cases, a carrier may seek dismissal based on discussions with shippers and a belief that it can be made profitable. The carrier should not be penalized for such an effort.

The amendment also requires the Commission to order oral hearing upon a request of a local protestant. Only if the Commission finds for good cause that such a hearing is impracticable or unnecessary, can an oral hearing be avoided. If held, the Commission's hearing costs would be borne by the railroad applicant.[6] New time frames for deciding abandonments set out in Section 10 of the bill are intended to accommodate such hearings. The hearing requirement would be imposed in all cases, investigated and not investigated, and could be requested at any time. The bill does not define "impracticable" or "unnecessary." Despite the additional 15 days allowed, we have doubts that these hearings are "practicable." We fear that the ministerial task of arranging for one, receiving a transcript, and analyzing it cannot be accomplished in this time. We now hold local oral hearings in investigated abandonments when a written record will not suffice (e.g., where crucial questions of fact require cross-examination). If this standard is contemplated, the proposal would not change existing procedures for investigated cases. To the extent, however, that the bill contemplates hearings prior to a decision on whether to investigate, we note that we do not now conduct such hearings. Our present procedure provides for investigations in all cases where substantial or significant problems are raised. For example, an investigation will be ordered if protestants have raised issues sufficient to put in doubt the accuracy of the carrier's claims regarding alleged losses or if abandonment is alleged to have a substantial, adverse impact on a community.

The requirement of oral hearings for virtually all protested abandonments would impose a cost burden on the government (and the railroads) which could not be recovered under the bill. For example, while the Commission now has only four administrative law judges, this provision would require employment of additional judges.

Finally, Section 10(c) amends section 10904(d)(1) by adding subparagraph (B), which directs the Commission to rely on line-specific financial data, instead of system-wide or industry-wide data, in making its abandonment decision. This change could cause a serious hardship on the industry.

Currently, the abandonment regulations permit numerous cost items to be calculated on the basis of averages. However, when more line-specific data has been introduced by parties, or is made available by carriers, it is relied upon. It is difficult, however, for the railroads to present line-specific costs going back over two years.[7] For example, one area where this issue has been raised is locomotive costs. Under this proposal, the carrier would have to identify every movement over the line during the years in question and then identify the locomotive type, the costs of that locomotive and the age of that locomotive. All this data would then be used to come up with a portion of locomotive costs, which is only a portion of the on-branch costs, which in turn is only a portion of the avoidable costs. Although this evidence may be somewhat more accurate, we question whether the cost to develop it in all instances is worth the incremental advantage. Moreover, it is unclear that protestants would be better off, since the complexity of the case, along with the litigating expense, would increase greatly.

STATE AUTHORITY

Section 11 of the bill deletes the provision in 49 U.S.C. 11501 for States to obtain certification as a prerequisite for intrastate rate jurisdiction and adds a new subsection to permit parties other than railroads to petition the Commission for review. The Commission is given 120 days to review State decisions and changes the Commission's duty from determination and authorization of appropriate rates to appellate review with the power to vacate and remand State decisions.

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[6] The bill does not, however, ensure that these funds accrue to the Commission and not the U.S. Treasury.

[7] Our rules require data for a number of years to insure that losses are persistent.

Our concern with this change stems from our traditional interest in minimizing inconsistent State and Federal regulation. Prior to the Staggers Act, this was a serious problem.

We believe that the procedures Congress enacted in the Staggers Act now work well. The certification process is almost complete. Few petitions for review of State actions are being filed. We can only infer from this that States have, by and large, adjusted their activities to reflect Federal law.

This proposal is likely to return us to the pre-Staggers Act situation of conflicting State and Federal regulation. There would be no finality to State decisions, and no incentive for the State to comply with Federal law, as our sole remedy would be to remand.

TRANSITIONAL PROVISIONS

This is the last section of the bill, designed to clarify the scope of coverage and the extent of retroactivity of the new law. Section 12 provides that the amendments made by the new law will not apply to rates in effect on the effective date of the Staggers Act and not challenged within 180 days thereafter in accordance with section 229. It provides that a party that entered into a rail transportation contract prior to or during the 180-day period before enactment of the Staggers Act or before may challenge the rate that would apply at the expiration of the contract.

It is unclear what rates the new law will apply to. Does it apply to all rates in existence after its enactment? Is it only limiting the retroactive application of the new law? Does the same construction apply to intrastate rates? The provision does not explain whether or how the new law would apply to pending exemptions or exemptions already in effect, or to pending abandonment cases, or to open/closed §229 cases. The provision conceivably could result in the revisiting of virtually every railroad rate decision issued since the Staggers Act.

In sum, it does not clearly explain how each of the changes will affect pending cases or existing law (e.g., the status of existing exemptions); the ambiguities are reminiscent of those of Section 706 of the Staggers Act, which led to considerable unnecessary litigation. Finally, the prospect of revisiting most rate cases since the Staggers Act suggests a substantial increase in work.

In closing, I would like to reiterate the Commission's support for the Staggers Act. The rail industry has made great strides that could be jeopardized through passage of this bill. The Commission is attempting to accommodate the legitimate interests of both shippers and railroads. The undertakings mentioned earlier on competitive access, market dominance, revenue adequacy and relief for small shippers are evidence that progress has been and will continue to be made at the administrative level.

CONTRACT CHANGES PROPOSED BY SENATOR SYMMS

1. The bill would require full disclosure of all agricultural products contracts filed. This is a change from the Staggers Act, which directed us only to disclose nonconfidential information. Section 10713 has been perhaps the most successful provision of that Act. 34,000 contracts have been filed and, as of mid-1985, approximately 57% of all grain-related products are moving under contract.

This change eliminates any balance between confidential and disclosed terms. The National Grain and Feed Association recently reached an agreement with the AAR regarding what information should be disclosed to competitors. The bill goes far beyond that agreement, and we question whether it would receive the support of many shippers. The confidentiality provisions are for their benefit, not the carrier's.

2. This change would authorize use of contracts for privately-owned cars moving agricultural commodities. Reduced rates or allowances must be provided.

While we are not convinced that the bill's standard for such rates and allowances is a balanced one, as railroads "may" enter into these contracts we have no objection to this proposal.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question 1. In spite of the problems you have had resolving the boxcar matter, I understand that you have initiated an entirely separate proceeding to consider changes in the car hire regulations for freight cars other than boxcars. What is the status of that proceeding? Is this proceeding entirely separate from the boxcar proceeding? In your view, what are the main difference between these proceedings and the issues involved, and how might the results of the proceedings differ?

Answer. The Commission is considering changes in the car hire regulations for cars other than boxcars in Ex Parte No. 334 (Sub-No. 6), *Review of Car Hire Regulations.* This action was prompted by an almost industry-wide regulation that the existing car hires rules was having the opposite effect than the one intended. For example, in times of car surplus, the payment formula encouraged purchases of new cars. Public comments in response to an advance notice of proposed rulemaking were received by February 7, 1986, and are now under review.

This proceeding is entirely separate from the boxcar proceeding, Ex Parte No. 346 (Sub-No. 19) *Boxcar Car Hire and Car Service.* The issues are similar, since the other types of freight cars are subject to the same basic system of regulated car hires rates that exists for boxcars. Some of the surrounding circumstances are different, however. For example, as contrasted with boxcar movements, other types of freight cars carry traffic on which the freight rates are still regulated. Also, these types of cars are not as heavily used by short line railroads as boxcars are.

The Commission could adopt a different result in Ex Parte No. 334 (Sub-No. 6) than it did in the boxcar car hire proceeding. There, as you know, the Commission voted to adopt the Conrail/short line proposal for boxcars—retaining prescribed car hire but encouraging bilateral agreements, authorizing mileage charges and car hire reclaims on empty cars, and establishing exclusions and protections for small railroads. For other types of cars, the Commission could, for example, deprescribe car hire or continue prescription under a modified formula. The comments we have received from interested parties reflect a similarly wide variety of proposals reflecting many of the same positions and concerns raised in the boxcar proceeding.

Question 2. I am deeply concerned about any changes in the car hire or joint rate regulations which do not include adequate protections for small railroads. To illustrate the potential harm, Dakota Rail is a short line railroad which operates over 37 miles of track running from Milbank to Sissenton, South Dakota. For a typical shipment of barley from Sissenton to Minneapolis, I understand that Dakota Rail currently will net $50 after expenses. If the new car hire rules proposed by Conrail in 1983 were applied to this move, I am told that Dakota Rail would sustain a net loss of approximately $30 because of the 35 cents per mile empty mileage return charge. If the small railroad were faced with using a Class I car, it would sustain a net loss of $260 per movement. Would you agree with these approximate figures? If not, why? I you do agree, how can a short line be expected to remain in business under this conditions?

Answer. We are unable to comment on the accuracy of the figures presented since the rate, mileage, time, and car hire data are not specified. Nevertheless, to the extent Dakota Rail is concerned with boxcar rental charges, our decision in Ex Parte No. 346 (Sub-No. 19), adopting the Conrail/short line railroad proposal, protects it by guaranteeing the current level of per diem rental and prohibiting imposition of the 35 cents per mile empty return charge for cars it owns or leases. If it uses a Class I railroad's cars, an agreement with that railroad will govern cars compensation. Short lines complement their Class I connections; rarely do they compete with them. The larger carrier uses smaller carriers such as Dakota Rail as "feeder lines" and it would be in a larger carrier's interest to dry up traffic that the railroad could profitably handle together. To do so would eliminate a current source of profits which many larger connecting lines were unable to earn by their own, prior operation of the now-Class III carrier line.

The Commission has not yet determined whether or how to amend car rental rules for other types of cars, such as covered hoppers. As noted previously, this is an issue in the pending Ex Parte No. 334 (Sub-No. 6) proceeding. The impact on short line carriers will be addressed in depth there. The Commission recognizes the importance of viable short lines top shippers and the national transportation system and our decision will reflect these concerns.

Question 3. Your earlier boxcar order was reversed by the U.S. Court of Appeals. What were the reasons given by the court for reversing the order? Might the small railroad protections agreed to by Conrail make this order more acceptable to the court?

Answer. The court reversed the car hire provisions of our earlier exemption, finding that they constituted rulemaking and could not be adopted under exemption authority. It also remanded the joint rate portion of the rate exemption on the grounds that we had not adequately considered its impact on small carriers.

The small railroad protections agreed to by Conrail include continued regulation of joint rates on traffic to or from shippers located on Class III railroads. The Commission has voted to adopt these protections. Since the joint rate exemption will no longer apply to traffic handled by short line railroads, the court's concerns on the joint rate exemption should be satisfied.

As to the car service provisions, it is unclear what the court's reaction to our adoption of the small railroad protections will be. Its holding was based on procedural error, and it did not reach the substantive issues.

Question 4. It seems to me that the further concentration in the rail industry and the inevitable reduction in rail competition is a matter of legitimate concern to short line railroads. Do you agree? Could you examine the effect of a Norfolk Southern/Conrail merger on shorts lines in the region as it relates to the boxcar issue? Conrail has made it very clear that it will honor the agreement under present circumstances. However, I understand that the compromise agreement reached with Conrail is qualified to the extent that it would be inapplicable if there are any "material changes" in Conrail's structure (e.g., if Norfolk Southern and Conrail are merged). Are there any assurances that a combined Norfolk Southern/Conrail would honor the agreement? What would happen to the Conrail/short line boxcar compromise if Conrail is sold to a carrier such as Norfolk Southern which does not support the boxcar compromise.

Answer. As a general matter, a merger of two railroads with which a small railroad connects may be of concern to that railroad if it would reduce its bargaining strength for shipments which could have been handled eariler by either of the premerger carriers. In many cases, however, small railroads already connect with only one trunk line. Thus, in these instances there would be no real change in operating conditions. In any event, the Commission recognizes the need to evaluate carefully any allegation of anticompetitive conduct. Our new competitive access rules in Ex Parte No. 445 (Sub-No. 1), specifically address this issue with respect to connecting carriers. At the same time, however, much of the track now owned by short lines was transferred to them by the larger carriers with the idea that a lower cost, short line operator could keep the line open and feed traffic to the trunk line. The trunk lines have every incentive to maintain a good working relationship with these smaller connections.

A Norfolk Southern/Conrail merger would have no effect on any railroad's obligation to observe the small railroad protections contained in the Conrail/short line agreement. The Commission has voted to adopt these protections as rules applicable industrywide. Thus, they must be observed by all railroads.

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS

Question 1. The concerns about ICC's revenue adequacy determinations seem to focus on the method of computing the cost-of capital standard rather than on the standard itself. Could you briefly describe the areas of controversy and how they impact on the ultimate result?

Answer. To date, most of the criticism of the existing revenue adequacy standard has focused on: (1) its failure to adjust for deferred tax reserves, (2) its use of the current cost of debt, and (3) its use of retirement-replacement-betterment (RRB) accounting data. The Commission is currently reconsidering its position on all these matters. *See* Ex Parte No. 393 (Sub-No. 1), *Standards for Railroad Revenue Adequacy.*

The amount of income taxes deferred for future payment represents, in effect, cost-free funds available for use by the railroads. Critics have argued that our standard should be adjusted to reflect the cost-free nature of deferred tax funds. Many critics favor an approach whereby deferred tax reserves are deducted from the railroads' investment base, thereby increasing their return on investment (ROI). Such a deduction would, in effect, disallow the expectation of a return on that part of the investment base obtained with cost-free deferred tax funds. In the past, the Commission has maintained that such a deduction would foster disinvestment in the railroads.

Excluding the deferred tax account from the railroads' investment base in 1984 would have increased their composite ROI by 1.5 percentage points, from 5.7 percent to 7.2 percent (based upon depreciation accounting.) Increases in the ROI of individual railroads would have ranged from zero to 4.1 percentage points. None of the Class I roads would have become revenue adequate in 1984 by excluding deferred tax reserves from their investment base.

Under the existing standard, the railroads' composite cost of capital is calculated using the current cost of debt. Critics have argued that the composite cost of capital should be based on the railroads' embedded cost of debt, i.e., the average interest rate on all outstanding debt. They argue that the railroads' actual contractual debt obligation is represented by the embedded, [illegible] not the current, cost of debt. In the past, the Commission has maintained that the use of the current cost of debt is appropriate since it will enable the railroads to compete in current markets for scarce investment funds.

Use of the embedded cost of debt instead of the current cost of debt would have reduced the 1984 composite cost of capital rate by 0.7 percentage points, from 15.8 percent to 15.1 percent. However, even with the lower rate of 15.1 percent, none of the Class I railroads would have been revenue adequate in 1984.

Under the existing standard, each railroad's ROI is calculated using RRB accounting data. Critics have argued that railroad ROI should instead be calculated using depreciation accounting data.[1] Their arguments generally center around the fact that depreciation accounting is consistent with generally accepted accounting principles.

Depreciation accounting has been used for railroad equipment accounts for many years. In 1983, it was adopted by Commission order for valuing road and property accounts as well. The Commission order specified, however, that RRB accounting would continue to be used for valuing road and property accounts in revenue adequacy proceedings until inflation-adjusted accounting procedures were adopted by the Commission. Continued use of RRB accounting for road and track accounts was stipulated on an interim basis for a limited purpose because it provides a limited degree of recognition of inflationary price changes in the costs of road and track replacement. The composite ROI for Class I railroads in 1984 on an RRB accounting basis was 4.8 percent, compared to 5.7 percent on a depreciation accounting basis.

The cumulative effect of both the deferred tax adjustment and the use of depreciation accounting data would have increased the composite 1984 ROI by 2.4 percentage points, from 4.8 percent to 7.2 percent.

Question 2. You state in your testimony that the ICC agrees that its existing revenue adequacy standards "are not producing a realistic picture of the financial condition of the rail industry." What do you feel would be a more realistic picture? How do you feel this more realistic picture could be attained?

Answer. In our view, a more realistic picture would show the railroads moving closer to or achieving revenue adequacy since passage of the Staggers Act in 1980. This has not been the case, however. Since 1980, most railroads have moved farther away from revenue adequacy, a situation we would not expect given the regulatory freedoms granted to railroads in the Staggers Act. A more realistic picture would also be one which was consistent with the investment community's assessment of the industry's health. Our current revenue adequacy findings offer no such consistency. For example, the Commission's most recent revenue adequacy determination, for the year 1984, found that none of the Class I railroads were revenue adequate. *See* Ex Parte No. 463, *Railroad Revenue Adequacy—1984 Determination*. By contrast, the investment community considers many railroads to be financially sound and attractive as investments, as demonstrated by their bond and equipment trust certificate ratings of Baa or higher.

The Commission has already taken steps to address the revenue adequacy question. The commission recently issued a decision expanding the scope of the Ex Parte No. 393 (Sub-No. 1) proceeding to include a broad reexamination of the manner in which it measures and determines revenue adequacy, including the use of the current cost of capital as the sole standard of revenue adequacy.[2] This proceeding should result in a more realistic revenue adequacy standard.

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[1] RRB accounting capitalizes railroad track at original cost. Subsequent replacements of similar quality track are written-off completely as maintenance expense in the year in which they are made. The incremental cost of betterments, on the other hand, are added to the original property account as an additional capital investment. When a line is abandoned or discontinued, the original investment, plus the betterments, are then written out of the property accounts (at their original cost) as expenses. Depreciation accounting also capitalizes track at original cost. But this original cost, less, salvage value, is then prorated and written-off as a depreciation expense in constant-level annual increments, pro-rated over the life of the track. When the track is replaced, the cost of new track is capitalized and all of the remaining original cost of the track being replaced is written-out of the property account at that time and put into the accumulated depreciation account. The same procedure applies if the track is retired without being replaced.

Question 3. You indicate in your testimony that the changes proposed in S. 477 with respect to revenue adequacy determinations are "not necessarily without merit." What proposals in S. 477 possibly have merit? Would the ICC consider adopting them, and if so, why?

Answer. The Commission is presently considering the adoption of most of the revenue adequacy standard changes proposed in S. 477. As prevously noted, the Commission recently issued a decision reopening the Ex Parte No. 393 (Sub-No. 1) proceeding. That decision tentatively proposes the following for adoption, all of which are also proposed in S. 477:

(1) a revised ROI calculation designed to reflect only the income, expense and investment related to rail operations. We believe this proposed revision will result in a more accurate measure of rail profitability.

(2) the use of depreciation accounting data (rather than RRB data) for calculating railroad ROI's. Our concern here is that the use of RRB accounting data might no longer be justified, given the increased reporting burden associated with its use and its incompatibility with generally accepted accounting principles.

(3) the use of the actual (embedded), rather than the current, cost of debt in determining the composite cost of capital. This proposal reflects our concern that current debt rates might be appropriate for use only in connection with new investment decisions, not in revenue adequacy determinations which are based on a railroad's total operations, incuding operations funded with debt acquired over many years.

(4) an adjustment of deferred tax reserves. In our view, certain provisions of the tax law have allowed the railroads to generate large increases in their accumulated deferred tax accounts, over and above those that relate directly to new investment in railroad property. Given this situation, we are considered making adjustments for deferred tax reserves.

Question 4. S. 477 reflects the concern that the standard of stand-alone costs is not an appropriate and effective constraint on coal rates. How do you respond to this concern? What is the origin of this standard?

Answer. As it is being used by this agency, the stand-alone cost test is a new concept in federal regulation. Much of the concern expressed over its use as a measure of maximum rate reasonableness developed out of a misunderstanding of the stand-alone cost test (SACT) proposed in 1983, in Ex Parte No. 347 (Sub-No. 1) *Coal Rate Guidelines, Nationwide*. For example, some shippers commenting on the proposal believed that the SACT required the actual construction of a competing railroad. Others thought that the test precluded the grouping of non-issue shippers, thereby denying the issue traffic the benefits associated with large volumes.

A review of the Commission's final decision served September 3, 1985, and the more recent decision in Docket No. 38783 *Omaha Public Power District* v. *Burlington Northern* served January 15, 1986, reveals that the SACT can be both fair and analytically sound. The test is a method for determining the competitive entry costs for a hypothetical efficient competitor. Rates produced by the SACT should be sufficient to cover costs and yield a fair profit. In this way, the test should yield rates which are comparable with those that would be produced under competition. We expect that this test will be applied in a number of rate cases this year.

The stand-alone cost test evolved from our search for a means to assess the reasonableness of rates without establishing an arbitrary rate ceiling. For example, the Commission has been rebuffed by the courts when it tried to impose a rule limiting rates to 7 percent over fully allocated costs, since the 7 percent could not be shown to be any more reasonable than some other figure, say 6 percent or 8 percent. Thus, establishing a specific revenue-to-variable cost ratio or percentage rate increase is arbitrary and capricious, and rightfully would be struck down in court. And, since nearly every rate case involves transportation with unique characteristics, it was necessary to formulate a test that would be flexible enough to apply to whatever case might arise. The objective was to find an intellectually sound proxy for competition, to see what the rate would be for a specific movement over a specific line, if there were in fact competition on that line. Simply stated that is what the stand-alone cost test is designed to do.

The principle underlying the concept of stand-alone costs as a measure of cross subsidy has been accepted by the economics profession for many years. In formulating the coal rate guidelines, we relied on the verified statements and published works of well-respected economists, representing both shippers and railroads: Alfred Kahn, William Baumol, and Robert Willig, among others.

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[2] The Ex Parte No. 393 (Sub-No. 1) proceeding was originally instituted to refine and improve the existing standard.

Question 5. S. 477 shifts the burden of proof in rate reasonableness cases from the shipper to the railroad. What do you think would be the practical effect of this legislation? Do you think that this proposal would result in more cases held in favor of the shipper? Would this burden shift have made a difference in cases decided to date by the Commission?

Answer. We believe such a change would, as a practical matter, result in more findings in favor of shippers and in a greater number of challenges to railroad rates. This is because: (1) there would be a greatly reduced evidentiary and cost burden in the filing of complaints; and (2) the quality of proof often determines which side prevails. For example, the burden of proof in market dominance determinations was of great concern to shippers. They believed that the burden of showing evidence of product and geographic competition was too great for them to bear successfully. As a result, the Commission recently switched this burden of proof to the railroads. *See* Ex Parte No. 320 (Sub-No. 3), *Product and Geographic Competition.*

While a number of cases, especially in the market dominance area, have turned on burden of proof, it is impossible to say definitely whether the result in each case would have changed with a shift in burden, as that would depend on what additional evidence, if any, the railroads might have submitted. But, clearly, the party with the burden has the greater responsibility and, unless its case is convincing, the Commission, as a matter of law, must conclude that it has failed to meet its burden. *See, e.g.,* No. 36114 (Sub-No. 1) *Potomac Electric Power Company* v. *Consolidated Rail Corporation* (served July 22, 1983).

The Interstate Commerce Act, both prior to and after the 1980 Staggers Act amendments, reflects the basic legal tenet that the party seeking particular relief has the burden of proof. The shift proposed in S. 477 would also alter that scheme in a manner inconsistent with: (1) the Staggers Act's intent that railroad flexibility in ratemaking be encouraged; and (2) Congress' recognition that the preponderance of rail traffic subject to competition.

SEPARATE EXPRESSION OF COMMISSIONER LAMBOLEY

Burden of proof issues are admittedly difficult because what is typically at stake is not simply who has to carry the weight of logic and evidence, but who has to carry the weight of expense. Because railroad rate cases can become very technical, this issue of expense is a serious problem, and acutely so, for smaller shippers. The Commission recently issued a notice of proposed rules addressing this problem, as well as the issue of non-coal standards.

In general, I do believe that complainants should bear the ultimate burden of proof or persuasion, but after a prima facie showing on elements essential for recovery, can effectively shift the burden of going forward to respondent, and that showing, if not rebutted, should be sufficient to entitle complainant to decision in its favor.

Question 6. You indicate in your testimony that the section in S. 477 relating to enhancement of competition is similar in some respects to the competitive access regulations recently adopted by the ICC but is different in other respects. Could you briefly summarize the major similarities and differences?

Answer. S. 477's competitive access provisions are similar, in some instances, to our Ex Parte No. 445 (Sub-No. 1), *Intramodal Rail Competition,* rules. The proposed amendment to 49 U.S.C. 11103 [S. 477 Section 9(b)(2)] is identical to our rules in that the Commission is directed not to consider revenue adequacy or product competition in deciding whether alternative rail service is in the public interest. S. 477 also reflects, with minor language difference, the Ex Parte No. 445 (Sub-No. 1) rules regarding who may seek reciprocal switching or joint use of terminal facilities.

The two approaches are most different, however, in their remedial provisions. As to joint rates, our rules provide for 45-day's notice, advance justification, negotiation, and then guranteed suspension if a cancellation would eliminate effective rail competition. In the decision on the merits, we will evaluate the cancellation's effect on competition, and will conduct the efficiency analysis required by 49 U.S.C. 10705(e). S. 477, on the other hand, does not promote private sector agreements and would make joint rates or proportional rates mandatory, regardless of shipper transportation alternatives.

The carrier's need to price differentially, the relative efficiency of the different routes, and the market-and competition-based reasons for different rates may not be considered. Instead, only an arbitrary cost test would set the rate. Similar proposals were considered and rejected in Ex Parte No. 445 (Sub-No. 1) because they did not relate the rate to competition and, as such, did not reflect the basic premise of the Staggers Act.

For reciprocal switching and joint terminal use, S. 477 also applies an arbitrary cost test for setting compensation, and prohibits consideration of market factors and competitive circumstances. Most notably, it limits the analysis (contrary to Commission and antitrust precedent) to intramodal competition, thus ignoring the role intermodal competition may play in providing alternatives to shippers and constraining rail pricing.

Question 7. CURE will testify that no captive shipper rate has been ordered reduced by the ICC. What is your response to this characterization? What has been the track record for shippers at the ICC?

Answer. There have been 25 post-Staggers decisions, embracing 35 proceedings, a large number of which resulted in an initial decision granting rate relief to shippers. While these decisions were pending on appeal, the Commission was also revising its guidelines for deciding rate reasonableness cases. Again, some of these involve specific statutory provisions such as those dealing with recyclable commodities or the recent Commission decision in No. 36180 ordering refunds to the San Antonio Power & Light Co. Others have involved contracts entered into prior to the Staggers Rail Act, in which the Commission subsequently upheld the contract and prescribed a rate at the contract level.

In September, 1985, the Commission implemented final rules governing maximum coal rates (Ex Parte No. 347 (Sub-No. 1), *Coal Rate Guidelines*). In October, 1985, parties to pending rate reasonableness cases were requested to indicate how they wished to proceed in light of the new guidelines. In a number of these cases, the parties sought to introduce additional evidence consistent with the new standard. Procedural schedules have been set and the Commission's Chief Administrative Law Judge is overseeing discovery and/or evidentiary submissions. In some cases, the parties requested that the case be held in abeyance pending negotiations. As a result, two such cases have settled this month.

In the recent decision in Docket No. 38783, *Omaha Public Power District* v. *Burlington Northern*, served January 15, 1986, an administrative law judge applied the coal rate guidelines, finding in favor of the shipper complainant. The matter is now pending on appeal to the full Commission.

Although it has taken some time to have the analytical tools in place to decide these cases, we now believe we have workable guidelines, and are moving forward to porcess these matters.

QUESTIONS OF SENATOR SYMMS AND THE ANWERS

CONTRACTS

Question 1. In the past five years since enactment of the Staggers Act of 1980, in how many instances has the Interstate Commerce Commission found that a complaining shipper has been the subject of unreasonable discrimination?

Answer. None, although there have been a number of cases where the Commission granted discovery involving situations in which there was a good chance of finding unreasonable discrimination. All of these cases were settled prior to a final Commission decision.

Question 2. How soon after the filing of a contract must a shipper, believing itself the subject of unreasonable discrimination, petition the I.C.C. for disclosure of the contract's terms or be forever barred from learning its contents?

Answer. Our interim discovery rules in Ex Parte No. 387, *Railroad Transportation Contracts*, Provide that discovery petitions shall be filed no later than 18 days from the filing of the contract and contract summary. However, as the statute provides 30 days for the Commission to institute an investigation and 30 more days to complete it, this 18-day time period is flexible and can be extended should the facts warrant.

Question 3. How will such a shipper even have knowledge of the contract's filing within this short period of time?

Answer. The trade magazine *Traffic World* publishes a weekly summary of all rail contracts and amendments filed with the Commission. Also, several "watching services" are available to interested shippers. These watching services monitor the filings of contract summaries and amendments and can report to subscribers daily.

Question 4. Isn't the most effective mechanism for avoiding unreasonable discrimination the posting and publication of rates?

Answer. In the Staggers Act, Congress narrowed considerably the scope of unlawful discrimination. Under 49 U.S.C. 10741, a rate disparity that actually causes injury is not unlawfully discriminatory if it is justified by differences in transportation services or if the rates apply over different routes. The Conference Report (H.R Rep. No. 1430, 96th Cong., 2d Sess. 104 (1980)) states that the Commission should exercise its remaining power under section 10741 only where it is needed to prevent abuses of market power where discrimination cannot be supported by differences in demand for services or costs. Thus, legitimate cost or marketing factors excuse price differentials to competing shippers. In view of this more narrow application of the discrimination remedy, and in the interest of encouraging shippers and carriers to work together to improve and tailor service, we believe traditional posting and publication of contract rates should not be made mandatory.

While there are problems that remain regarding contract disclosure and we are studying them in Ex Parte No. 387, *Railroad Transportation Contracts*, contracting has been enormously successful. A posting and publication requirement could halt this progress. As we noted in our February 21, 1986 testimony before this Subcommittee, the confidentiality provisions benefit shippers not carriers. We question whether the proposal for mandatory publication of these provisions would be supported by many shippers. Certainly, it would make it easier for them to know the rates being charged their competitors. It may not, however, be the best way to encourage the most efficient and economical rail operations and rates tailored to particular situations.

SEPARATE EXPRESSION OF COMMISSIONER LAMBOLEY

Since joining the Commission, I have participated in cases involving contract filing, tariff information disclosure and discovery issues in which I have expressed the view that Commission rules are perhaps too restrictive, basically concluding in each instance that: "Fair access to accurate information is a premium no matter the forum, be it in the marketplace or in litigation."

See for example separate expressions in:

Ex Parte No. 387 (Sub-No. 958) (Notice of Contract Filing), *Exemption from Regulation—Shipments Subsequently Made Subject to a Contract Rate* (Decided: November 20, 1985).

Ex Parte No. 370 (Tariff Information), *Tariff Improvement* (Decided: February 4, 1985).

Ex Parte No. 39498 (Tariff Information), *Olin Corporation* v. *Burlington Northern Railroad Company, et al.* (Decided: September 13, 1985).

No. 37021 (Discovery), *Annual Volume Rates on Coal—Rawhide Junction, WY to Sergeant Bluff, IA.*

No. 37029, *Iowa Public Service Company* v. *Burlington Northern Railroad Company and Chicago and North Western Transportation Company* (Decided: March 11, 1985).

Question 5. Haven't the Canadian National and the Canadian Pacific, which had the right to negotiate contract rates long before United States railroads did, been obliged to post and publish their contract rates?

Answer. Yes. Under Canada's Tranport Act, agreed charges (contract rates) are required to be published and filed. In Canada, freight rates (including agreed charges) as well as the conditions under which the rates apply are public knowledge. It is our understanding that Canada is now exploring the possibility of adopting railroad contract rate rules and regulations similar to those authorized by the Staggers Act.

BOXCARS

Question 1. Should the railroads be considered common carriers in performing transportation under contracts negotiated pursuant to section 208 of the Staggers Rail Act of 1980, 49 U.S.C. 10713?

Answer. Section 208 of the Staggers Act established a new category of railroad rates. While the authority to contract is not as broad as what exists for motor contract carriers, it was intended to create a new type of service option dependent solely on shipper-carrier agreements as an alternative to traditional common carrier service. As such, we believe carriers operating under contracts should not be considered common carriers vis-a-vis their contract shippers.

It appears from your questions that you are concerned with adequate car supply. We note that contracts are ideal for guaranteeing that identified car needs are met. The contract commitment allows the parties to rely on the agreement and to plan and invest accordingly. Nevertheless, contracts are purely voluntary. Thus, a shipper may choose tariffs over contracts and rely on traditional, statutory car supply obligations. *See* 49 U.S.C. 11101 and 11121.

Question 2. Should the railroads be considered common carriers in performing transportation that has been exempted by the Interstate Commerce Commission pursuant to section 213 of the Staggers Rail Act of 1980, 49 U.S.C. 10505?

Answer. The Interstate Commerce Act incorporated and superseded common carrier duties under common law. Thus, when the Commission exercises its exemption power, it removes certain (or all) common carrier obligations or prohibitions. The degree to which railroads continue to be common carriers subject to the Act's requirements depends on the scope of the exemption. Most exemptions are limited. For example, the boxcar exemption did not extend to the provisions of the Act governing car supply. *See* Ex Parte No. 346 (Sub-No. 19), *Boxcar Car Hire and Car Service*.

If a party believes that a carrier is abusing its market power in using an exemption or that re-regulation is necessary to promote transportation policy goals (*see* 49 U.S.C. 10505), its remedy is to file a petition to revoke that exemption. As noted above, common law, common carrier obligations pertinent to the scope of an exemption are not revived because the Commission's jurisdiction is exclusive even if we have chosen not to exercise particular authority. *Consolidated Rail Corporation—Declaratory Order—Exemption,* I.C.C. 2d (served March 5, 1986).

Question 3. Insofar as the railroads are not common carriers, however, have they any obligation to provide shippers with cars for loading their freight?

Answer. Sections 11101 and 11121 of the Act are the primary car supply directives. If the Commission has exempted carriers from the requirements of these sections, they have no common carrier obligation to provide cars. This result is consistent with the scope and intent of 49 U.S.C. 10505. That is, if we find that regulation is not necessary to carry out the national transportation policy and is not needed to protect shippers from market power abuse (we rarely rely *solely* on the alternative "limited scope" criterion), we will have found that competition will ensure adequate service to shippers.

As noted in the previous response, many of our exemptions (including boxcars) do not remove the car supply obligation. In those that do, we have no evidence that, as a result of an exemption, railroads have departed from particular markets. In fact, the reverse appears to be true. For example, the TOFC/COFC and fresh fruits and vegetables exemptions have produced a dramatic increase in rail market share and related equipment and facilities investment.

Question 4. Would the answer be different if the question as to the railroads' common carrier obligation pertained to specialized cars, as for example all-door cars uniquely suited for the loading of finished lumber?

Answer. As a general matter, we do not believe the answer would be different. If a rail carrier were exempted from its statutory obligation to provide adequate equipment, the Commission in doing so would have found that effective competition existed to fulfill equipment needs, whether specialized or not. However, as noted in the prior responses, the statutory obligation to furnish boxcars was not removed in the boxcar exemption. A complaint can always be filed challenging a carrier's car supply practices. We have no information that shippers have not been allowed to provide necessary equipment that the railroads could not or did not provide.

Question 5. If the railroads do not consider that they need to furnish their shippers with specialized cars, shouldn't their shippers be permitted to tender traffic in such equipment, assuming, of course, it satisfies A.A.R. and D.O.T. specifications?

Answer. Generally, railroads use a considerable number of shipper-owned cars. Unit-train coal movements are often performed in shipper equipment, and the majority of tank cars in service nationwide are shipper-owned or leased. It would appear that, where the carriers see the need for additional or different equipment and are unwilling to undertake major investment in it, they do allow the use of shipper cars.

A specific answer to this question depends on whether the Commission would find that such specialized cars are reasonably necessary for safe and adequate car service. *See* 49 U.S.C. 11101 and 11121. Without all the relevant facts, we cannot say definitely what our conclusion would be. It may be that such cars are not *required* by the shippers but simply represent desirable equipment improvement. (We note that this type of traffic now appears to move in both rail and motor service.)

We would point out that, in a somewhat related matter, we have consistently held that railroads need not give preference to shipper-owned equipment (despite its conforming to AAR and DOT specifications) if railroad-owned equipment is available that is adequate to meet transportation needs. Holding otherwise would promote uneconomic and wasteful investment and leave railroads unable to recover their costs on equipment investment. Ultimately, these costs would have to be borne by the shipping community.

Question 6. If they should be permitted to tender traffic in such equipment, would it not be reasonable and equitable that the shippers be compensated, by way of rate reductions or, alternatively, the receipt of allowances?

Answer. If shipper equipment is used, this fact should be and typically is reflected in the rate. This would not, however, be the only criterion in developing the rate, since other factors such as market forces (including competition), any empty backhaul that would occur, or the carrier's cost in foregoing the use of its own equipment must be considered. We have held that reasonable car compensation does not necessarily equal the car ownership cost. The market for the cars (*i.e.*, supply and demand) must be considered because the compensation must be reasonably related to the rate the carrier is able to collect for the freight in the car, with the carrier obtaining an acceptable return. Thus, even if an allowance or rate reduction is provided, it might not equal the car ownership cost.

Question 7. Wouldn't the railroads be spared ownership costs—their investment in such equipment, major repairs and the like—insofar as transportation were rendered in shipper-owned equipment?

Answer. Yes. Certain ownership costs would be spared but other costs would be created, such as the cost of foregoing the use of existing carrier equipment and the possible increase in empty mileage and operating costs due to the inability to use a specially-configured car for other traffic (*e.g.*, backhaul movements).

Question 8. Wouldn't a discriminatory situation develop if the railroads rendered contract or exempt transportation at identical charges for shippers furnished railroad-owned equipment, on the one hand, and, on the other hand, shippers providing their own equipment?

Answer. As noted previously, under the Interstate Commerce Act (49 U.S.C. 10741), unlawful discrimination is defined very narrowly. Rail rates applicable to different routes are *per se* not discriminatory. *See* 49 U.S.C. 10741(f)(4). And, the statute excuses discrimination if it is justified by a difference in costs or competitive conditions. We cannot say in the abstract whether the situation described above constitutes unlawful discrimination because a detailed factual analysis is required on a case-by-case basis. Nevertheless, it is extremely unlikely that this situation would arise under contracts or on exempt traffic. Since contracts are voluntary, no shipper need agree to one that does not provide compensation for the shipper's equipment. Exempt traffic is very competitive and, thus, shippers may use alternatives rather than acceding to such an arrangement.

Senator **Packwood**. Now, let us move on to Mr. W. Reid Thompson and Mr. William H. Dempsey.

Mr. Thompson of Potomac Electric Power Co. will be speaking on behalf of the Consumers United for Rail Equity, and Mr. Dempsey on behalf of the Association of American Railroads.

STATEMENTS OF W. REID THOMPSON, CHAIRMAN, POTOMAC ELECTRIC POWER CO., ON BEHALF OF CONSUMERS UNITED FOR RAIL EQUITY; AND WILLIAM H. DEMPSEY, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS, ACCOMPANIED BY J. THOMAS TIDD, VICE PRESIDENT, LAW

Mr. **Thompson**. Mr. Chairman, I appreciate the opportunity to appear before this committee on behalf of the CURE organization, Consumers United for Rail Equity, and testify on behalf of this S. 477.

Let me make three quick points if I may, Mr. Chairman, as a background for my testimony. The first point is that this coalition I represent here today is a broad-based one. It is made up of utilities, coal producers, shippers of grain, agricultural commodities, many consumers groups, the Consumer Federation of America, the Association of State Regulatory Commissions, a broad-based issue that has attracted the interest of consumer groups throughout the United States.

The second point I want to make is comparable to the first, and that is this is a consumer issue. I appear here as chief executive of a utility who is a major user of coal, but the issue is a consumer issue because no profit inures to a utility on the shipment of coal. It is a passthrough cost directly to the consumers, and when the costs go up or down the burden is visited upon the consumers that the utility serves.

Now, the third point I want to make quickly is that this is an important matter. Coal is the most significant product but it is extremely important to agricultural products and other things as well.

Coal is used for half the electric generation in the United States, and the electric industry uses 78 percent, I believe, of all the domestic coal produced.

Coal hauling, gentlemen, is 40 percent of the railroad tonnage in the United States, and the bill, the annual bill for the freight rates for the utilities is about $5.5 billion for this coal haulage charge.

I said half the electricity is generated by coal, and about two-thirds of all that coal, or a little better, is hauled by rail. That gives you some idea of the magnitude of the problem.

The next point I want to make is that we do not advocate by this bill the repeal of the Staggers Act, nor do we advocate the reregulation of the railroads. As has been adequately and totally pointed out here, we have simply a few measures that would fine tune that Staggers Act to make it, in our opinion, workable. So, then, I want to state the problem briefly, and about four points on the specifics.

I think the problem has been eloquently expressed here this morning by the Chairman of the ICC when she says to this committee, and I quote her exactly, and she said it two or three times, "We are about to begin." We have not begun, Mr. Chairman, we are about to begin, after 6 years, to consider some of the problems relating to the captive shippers.

Senator Ford asked about the time it takes rate cases to go through the ICC. My company has two pending since 1980, and they are not moving with any alacrity that I can see at this point.

Now, I think another most interesting thing brought out here as to what the problem is, it is perfectly apparent that the ICC has done nothing, by their own admission, not one thing, in 6 years. It is also perfectly apparent they did not intend to do anything, and would have done nothing, and may yet do nothing. The only reason they will move at all, if they do, is because of the pressure of this committee and the committee in the House, and the introduction of this bill. They said so.

Mr. Chairman, you read a most interesting letter this morning from a constituent of yours who testified here in November that he could get nowhere in dealing with the Union Pacific. They would not even hear him.

Senator PACKWOOD. It was the Southern Pacific.

Mr. THOMPSON. I am sorry, the Southern Pacific. An interesting thing occurred, and if you will indulge me, for an old story, briefly when the company put in the new pension plan that required a unanimous consent of their employees, one held out. The chairman called him in and said, look, Joe, this pension plan is important to everybody, and if you do not agree to it you are fired. Joe said, "Here, let me sign it." Some of his fellow employees said "why did you change your mind?" He said, "I had not had it explained to me so I could understand it."

The Southern Pacific did not understand the issue, Senator.

Until you went with the shipper and met with him, and if we could count on you to appear with us, each of us, in dealing with the railroads, it would be an entirely different matter. Of course, you cannot do that.

All we are suggesting here, simply, in a few, very small matters, that you incorporate into the law the same sort of attention-getting for the railroads that you provided in your own person, Senator, in that case out in the Far West.

What are some of these things? Let me just mention four quickly. The first thing that has been discussed here at some length is revenue adequacy. The Chairman, or the Chairlady, says they are looking at that. Let us see what the record shows. Well, it is a curious thing. The only thing put out officially on the subject that I have gotten any hands on was put out in December 1984, December 17, in which they made the determination for revenue adequacy for 1983.

Why have they not made the determination for 1984 yet? I can tell you exactly why. They are embarrassed to put out the figures that they have calculated. As she said, they finally understood it. This is a curious thing. Do you have any confidence in the competence of a commission that says they finally began to understand what everybody else knows intuitively about the revenue adequacy of the railroads?

I want to tell you what is on the record of the ICC on that subject. Here is the document they put out in December 1984 and found revenue inadequacy for 1983 for all the railroads. Here is what they said. She says they are considering changing the methodology. The only thing you have in print is what they say here about that change. They say we believe that sound economic regulatory decisions cannot be made without considering the impact of inflation, so we are currently studying, they say, accounting procedures which would take inflation into account. One procedure we are considering, called trended net original cost, and so on.

What they said to you, on the record, is that they have made a determination for 1983 revenue adequacy and found all the railroads inadequate, but that their methodology was flawed, as she said here today. They said if you use the method we really ought to be using, they would all be losing money.

Far worse, Mr. Chairman, here is the document. What they found there, they found, for instance, that the Norfolk & Western was earning 5 percent, Southern Railway 4—before they combined but they said the method we really ought to be using, and I presume that is what they are now considering, is a method that does not account for real expenditures of funds but it accounts for reproduction costing. In that case, those two railroads would be actually losing money, not making it.

Of course, that is all an absurdity, Mr. Chairman, on the face of it, the whole method of computing revenue adequacy. What we say to you in this bill is, if they are about to begin, we would urge this

Congress to give them just a little assistance in figuring out how to go about it over there; a little sensible assistance.

I guarantee to you on this committee that if they use the methodology that they have even intimated they might move to, and all they said they might do is quit putting in a return on deferred taxes, well of course, how did they ever get it in the first place? The Congress has let them keep taxes for a while and use it, defer it, for investment. Now the ICC says they ought to earn a return on it. It did not cost them a nickel, no cost, but they are to charge their customers a return on that capital.

Furthermore, the methodology used—and she did not say they were going to change this and I would be shocked if they did—the method they used to compute the return is a fantasy method. It does not compute the return on real invested capital by the railroads; rather, it computes the return as if they had made all the capital investments today, if they borrowed all their money today at whatever the rates were.

Fortunately, bond rates are going down but when they were making deteminations these they were as high as 14, 15 percent when the embedded cost may be 7 or 8. That is the revenue adequacy thing, and this bill fixes that very simply. There is nothing startling about it. I do not know why the railroads object. Using our methods, Mr. Dempsey says it would not make but one railroad revenue adequate.

A second point, and Senator, you hit upon this a moment ago very forcefully, Senator Rockefeller, about the burden of proof. That is the only change we propose in this Staggers law. The only change in the law itself of any significance is to change the burden of proof.

The Chairman of the ICC or the young lady with her gave you a totally erroneous answer about where the burden of proof normally resides. She said whoever files a complaint has the burden of proof, and in all regulatory proceedings I know about anywhere except the ICC, the company who files the rate has the burden of proving the reasonableness of it. I do not think you will find another regulatory body anywhere in the world that puts the burden on the shipper, on the user of the service. As was pointed out, they have all the facts and figures.

So we would suggest that the second thing, the burden of proof ought to shift to the railroad and not the shipper.

A third thing is this rate reasonableness test. Mrs. Gradison pointed out that it took them 6 years, or 5½, to adopt a test and that is the same crowd over there that urges you to give them a little more time to see how to apply it. It took them 6 years to adopt a test, and they came up with the most bizarre thing I ever heard of in regulatory proceedings. No wonder it took them so long to adopt any such strange test, called stand alone cost.

What kind of foolishness is that, Mr. Chairman, to require a shipper like our company to put in evidence about building our own railroad in Pepco's case, right through the heart of Alexandria, right through the heart of Washington, to get to our coal plants and show all those kinds of things?

It would cost hundreds of thousands of dollars to put such a theoretical piece of junk together when simple men, ordinary, sensible men can sit down and devise a cost-based methodology for determining the reasonableness of the rates, and we do not tell them how to do it in this bill. We just said go back and put out something sensible, which any group of us could do in 3 or 4 days.

The fourth point I want to make, and this is significant. It has been alluded to here, and that is this rail inflation adjustment factor. You know how that works, and that is real money. Every quarter the railroad sends in estimated cost figures for next quarter.

In December, it was pointed out here, they sent in some figures and said we estimate fuel costs, that is oil costs, are going up 5 percent in the quarter we are in now, and on that basis the whole cost smear produces an adjustment which can lead to a rate increase in every railroad.

There are two things wrong with that rail-cost adjustment factor. One is they do not base it on cost anyhow. They base it on prices. If the price of an article goes up, like the wage goes up, the dollar amount of the wage, that is factored into it. Never mind that they have 10 fewer employees. Never mind what the actual cost is to the railroads. It is a unit price concept, so the bill would fix that and it would take care of productivity.

The second most important point on that is that the rates never go down. For four or five quarters in recent times, the cost even, on that filing, went down, but the ICC does not permit rates to go down. They can only go up. They cannot go down. Is that fair? We say it ought to go both ways.

So those are some of the basic things, Mr. Chairman. I would be glad to undertake to answer any questions.

[The statement follows:]

STATEMENT OF W. REID THOMPSON, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, POTOMAC ELECTRIC POWER CO. ON BEHALF OF CONSUMERS UNITED FOR RAIL EQUITY

Mr. Chairman and members of the subcommittee, my name is W. Reid Thompson. I am Chairman of the Board and Chief Executive Officer of Potomac Electric Power Company. I appear before you today on behalf of Consumers United for Rail Equity. The members of C.U.R.E. and the members of the C.U.R.E. Coalition thank you, Mr. Chairman, for scheduling this hearing and for providing us the opportunity to present our views to you today.

We will be testifying today in support of the Consumer Rail Equity Act, S. 477, as introduced in revised and simplified form on October 31, 1985. The Consumer Rail Equity Act is cosponsored by thirteen Senators, including six members of the Commerce Committee. First, Mr. Chairman, let me describe Consumers United for Rail Equity and the C.U.R.E. Coalition.

CONSUMERS UNITED FOR RAIL EQUITY

Consumers United for Rail Equity is a non-profit organization of shippers that became active in July 1984. The objectives of C.U.R.E. are to unite consumers, captive shippers of bulk commodities and other shippers in an effort to inform the public, members of Congress and the Administration concerning the problems encountered under the Commission's implementation of the Staggers Act and to work for responsible, effective legislation that will correct these problems. Today, C.U.R.E. is composed of 76 members of which 38 are investor-owned electric utilities, 15 are publicly owned electric companies, 7 are rural electric generation and transmission cooperative and 16 are coal producers. Our members operate in 35 states, collectively account for 46 percent of the nation's generating capacity and produce more than 25 percent of the nation's annual coal production. A list of the C.U.R.E. members is included as Attachment 1.

THE C.U.R.E. COALITION

The C.U.R.E. Coalition is a broad-based group of organizations joined together to work with C.U.R.E. members to achieve our common objectives. Former Secretary of Agriculture and member of Congress, Bob Bergland, who is now the Executive Vice President of the National Rural Electric Cooperative Association, serves as convenor of the C.U.R.E. Coalition.

The Coalition is composed of a wide range of governmental groups such as the United States Conference of Mayors, the National Association of Regulatory Utility Commissioners and the National Association of State Utility Consumer Advocates; consumer groups such as the Consumer Federation of America; labor unions, such as the United Auto Workers and the United Steelworkers of America; all three utility associations, including the Edison Electric Institute, which represents the investor-owned utilities, the American Public Power Association, which represents publicly owned utilities, and the National Rural Electric Cooperative Association; coal associations, including the National Coal Association and the Mining and Reclamation Council of America; agricultural groups, such as the National Farmers Union, the American Bankers Association and the National Council of Farmer Cooperatives; as well as a number of other groups and associations. A list of the members of the C.U.R.E. Coalition is included as Attachment 2.

Each of the C.U.R.E. members and C.U.R.E. Coalition members, while diverse in nature, shares a common concern about the ICC's failure to implement properly the provisions of the Staggers Act relating to captive shippers and consumers. Where the transportation of coal to utilities is involved, our electricity customers pay the railroad haulage rates. For utilities, every dollar of our railroad coal haulage costs are reflected in our customers' electric bills. Public service commissions do not allow utilities to make a profit on coal costs or the cost of railroad haulage or to keep any reductions in railroad haulage rates that we are able to achieve. The publicly owned utilities, rural electric cooperatives and investor-owned utilities are concerned about the implementation of the Staggers Act on behalf of our electricity customers.

I. The Commission's Implementation of the Staggers Rail Act Has Effectively Negated the Shipper Protection Provisions of the Law:

A. Overview

The members of Consumers United for Rail Equity and the C.U.R.E Coalition support the Staggers Rail Act of 1980, but believe that the Commission has failed to implement the shipper protection provisions of the Act in a balanced and sensible manner.

We agree that market forces are superior to regulatory agencies in determining appropriate prices. Thus, the Staggers Act appropriately deregulated the nation's railroads where competition exists. The contracting authority in the Act has been of critical importance to both the railroads and shippers where competition is available. We also support the process in the Staggers Act that is meant to assure that captive shipper rates are not "unreasonable," that the railroads are not using their systems to deny access to competing railroads, thus creating new captive shippers, and that the railroads are not abandoning economic facilities.

Dr. Mark Cooper, speaking for the Consumer Federation of America, summarized the concerns of consumers very well in his November 4, 1985 testimony before this subcommittee:

Our member groups regularly participate in proceedings at the Federal and state levels, as have I on numerous occasions. We win some cases and we lose some, but above all, we have a sense that the process is reasonable—that the rules are impartial and the deliberative bodies are engaged in a good faith effort to balance the needs of consumers and the providers of monopoly services.

That simply is not the case with the ICC's implementation of the captive shipper provisions of the Staggers Act. The scales have been so tilted in favor of the railroads and the burden placed on complainants so onerous, that we despair of getting a fair hearing or achieving a sensible result.

All we are asking Congress to do is to ensure and equitable set of rules applied by a reasonably impartial body and we will take our chances on the process.

Specifically, the Commission has:

Established standards for evaluating the adequacy of a railroad's revenues which are at odds with financial reality and which no railroad now satisfies, or will in the foreseeable future satisfy. The resulting apparent inadequacy of the railroad's revenues is in turn relied upon to justify the reasonableness of the railroad's rates for captive shippers.

Established guidelines for determining rate reasonableness which focus on theoretical "stand alone" costs, namely the costs for the shipper to provide the service in some alternative fashion rather than the relationship of the rate to the railroads' actual costs and profits. Under these guidelines, monopoly rates are effectively unrestrained.

Established standards for determining whether a shipper is subject to railroad market dominance (i.e. is captive) which have turned what was intended to be a simple test for establishing the jurisdiction of the ICC into complex, antitrust-type evidentiary battles.

Established a cost inflation index which ignores the effect of productivity in measuring changes in costs, and provides for rates to be adjusted upward for increases in costs but not downward for decreases.

Permitted the railroads to engage in joint rate and reciprocal switching agreement cancellations and other anti-competitive practices.

Failed to implement to provisions of the Staggers Act intended to further increase competition through reciprocal switching.

Made the burden of proof imposed in shippers that are challenging the reasonableness of rates a virtual impossibility to satisfy as a result of the overwhelming complexity and unfairness of the entire rate regulatory process established by the Commission.

Over a year ago, the ICC began an unprecedented public examination of its actions under the Staggers Act and has adopted several new policies and procedures as a result of those discussions. However, the new result of the Commission's actions and inactions in the past year is that captive shippers are still without a forum in which to determine the reasonableness of their rates and the Commission still does not act to assure competition among railroads. Employing the principles that it adopted to implement the Staggers Act, no railroad is considered today to be revenue adequate by the ICC and the Commission has yet to order any captive shipper rate to be reduced.[1] Thus, the members of C.U.R.E. and the C.U.R.E. Coalition now turn to Congress because we are convinced, on the basis of the ICC's rules, regulations and decisions in individual cases, that the system at the ICC that the Staggers Act contemplated for assuring reasonable captive shipper rates and competition among railroads can only be secured by further Congressional action.

B. Rising Railroad Rates and Falling Railroad Costs

Mr. Chairman, the railroads obviously do not like to discuss whether or not the Interstate Commerce Commission has been balanced in its implementation of the Staggers Act. Rather, the railroads argue that they have shown great restraint and have not abused their monopoly pricing power since the Staggers Act was enacted. The railroads place heavy emphasis on the average level of rate increased that have occurred since Staggers, which are then compared to the rate of general inflation and other such numbers.

This emphasis by the railroads on averages diverts attention from the true issue, namely the unreasonable levels of individual captive shipper rates. Two points must be emphasized. First, our complaint is directed at actual railroad rates charged to captive shippers, not average rates that no one pays. The docket of ICC is replete with examples of unreasonable captive shipper rate, but no captive shipper has yet won final rate relief from the Commission. Congress included provisions in the Staggers Act to assure that no captive shipper pays an unreasonable rate. The issue we raise is simply whether those provisions are working.

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[1] In a letter dated October 16, 1985, to Chairman Philip R.Sharp of the Subcommittee on Fossil and Synthetic Fuels, House Committee on Energy and Commerce, President William H. Dempsey of the Association of American Railroads submitted a list of three cases in which he suggested the ICC has ordered a captive shipper rate to be reduced because it was unreasonable. Two of these cases, Docket No. 37276, Coal, Wyoming to Redfield, AR, and Docket No. 37409, Aggregate Volume Rate on Coal, Acco, UT to Moapa, NV, were filed before the enactment of the Staggers Act and decided shortly after passage of the Act under pre-Staggers Act principles. In a November 27, 1984 letter to Honorable Nick J. Rahall, II, Beryl Gordon, Associate Director of Governmental Affairs at the ICC, stated that both of these cases were decided on the basis of "outdated market dominance and rate reasonableness standards." Moreover, both cases are included in the Commission's order served October 3, 1985, reopening pending coal cases for reconsideration in accordance with the recently announced Coal Rate Guidelines in Ex Parte No. 347 (Sub. No. 1). Thus, while in the Redfield case, the rate was ordered reduced by 12 cents per ton for a period of approximately 17 months, no reparations were ever paid. That decision was based on pre-Staggers Act principles and complainants must now prove their case based on the Coal Rate Guidelines.

The third case cited by Mr. Dempsey, Docket 38566, Rates on Iron Ore to Escanaba, MI, was not a rate reasonableness case, but rather concerned a contract which the railroad attempted to disavow by filing tariffs at higher rates. The Commission found that the contract was binding and disallowed two of the tariff rates, but allowed the railroad to reject the third contract rate on the ground that the rate was too low and it would be "contrary to the Staggers Act" to hold the railroad to its negotiated contract rate. Thus, all the Commission did was to hold the railroad to two of its contract rates, but allow an increase in the third contract rate.

Second, the railroads seek to divert attention from the relationship between their cost decreases since the Staggers Act was enacted and their rate increases on captive shippers during that same period. Generally, a rate in and of itself does not tell much about its reasonableness. Reasonableness can only be determined by comparing the price that is being charged for a service to the costs that are incurred in providing the service.

Railroad operating costs have declined significantly since 1980. Fuel costs are down, interest rates are down, overall labor costs are down and the railroads have achieved increased efficiency, particularly in coal haulage. The vast majority of coal transported by rail moves in highly efficient unit train or trainload shipments. Ironically, utility shippers, many of whom are captive, are providing more railroad equipment, thereby reducing the railroads' costs. For instance, as of the end of 1983, utilities owned more than 33,000 coal cars, a tenfold increase in the last 10 years, and have made substantial investment in terminal facilities.

Recent productivity increases in the railroad industry also have affected the cost to the railroads of moving coal. According to the Executive Vice President of the Association of American Railroads (AAR), the railroads moved 914 billion ton miles of traffic in 1984, about the same amount as in 1980. But, they used 11 percent less equipment, 11 percent fewer cars, and 12 percent fewer locomotives. They also employed 31 percent fewer workers.

In fact, in its November 1, 1985 testimony before this subcommittee, the Association of American Railroads documented their cost decreases since 1980 stating:

The average freight train load has increased 17 percent;
Freight train-miles per train-hour have increased 18 percent;
Ton-miles per gallon of fuel consumed have increased 17 percent;
Ton-miles per employee have increased 38 percent;
Ton-miles per mile of road have increased 9 percent.[2]

In 1985, the Edison Electric Institute (EEI) had the occasion to analyze the profitability inherent in the railroad tariffs of 19 specific captive utilities. The analysis was made when a preliminary DOE study of railroad rates failed to analyze the profitability of the rates in the eight case studies selected by the DOE. The EEI analysis used standard ICC methodology for determining and allocating costs and data provided to the ICC by these companies in their rate complaints. The analysis accounted for unit train efficiencies experienced to those haulages. The analysis showed that the pre-tax returns on investment by the railroads inherent in these coal tariffs ranged from a low of 51 percent to a high of 157 percent—the latter for one of my company's own tariffs. (See the Table included as Attachment 3.)

C. Examples of Captive Shipper Abuses Under The Commission's Implementation of The Staggers Act

The docket of the Interstate Commerce Commission contains ample evidence of cases in which captive shippers believe they have been charged unreasonable rates. These cases involve at least 12 different commodities.[3] Let me describe briefly the experiences of several captive shippers.

1. Electric Utilities

At Potomac Electric Power Company, approximately 85 percent of the electricity we generate for our customers is fueled by coal. Each of our coal-fired generating facilities is cap[illegible] single railroad for the delivery of our coal. From 1979 to 1984, our coal haulage rates increased approximately 80 percent. Approximately 30 cents of every dollar of the delivered cost of our coal is for railroad haulage. Our railroad haulage bill totalled approximately $100,000,000 in 1984. Two of our complaints against our railroad carriers have been pending at the ICC since 1980. Neither has been decided by the Commission.[4]

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[2] Statement of William H. Dempsey, President, Association of American Railroads, Before the Subcommittee on Surface Transportation, Senate Committee on Commerce, Science and Transportation, November 1, 1985, at 5.

[3] These commodities include aluminum (*Anaconda* v. *Burlington Northern*, Docket 37550 and other cases), wheat and barley (*McCarty Farms* v. *Burlington Northern*, Docket 37809), phosphates (*Mobil Chemical* v. *Seaboard Coast Line*, Docket 37583 and other cases), soda ash (*Allied Chemical* v. *Ann Arbor*, Docket 38412S), sugar (*Amstar* v. *Alabama Great Southern*, Docket 38239), corn syrup (*Amstar* v. *Atchison, Topeka & Santa Fe*, Docket 37478), clay (*International Minerals & Chemicals* v. *Burlington Northern*, Docket 38084), pulpwood and wood chips (*Consolidated Papers* v. *Chicago & North Western*, Docket 37626), magnesium ingots (*Aluminum Co. of America* v. *Burlington Northern*, Docket 37699), and spent nuclear fuel (*United States Department of Energy* v. *Aberdeen & Rockfish*, Docket 38376 and other cases).

The experience of the Kansas City Power & Light Company (KCPL) is also illustrative of the difficulties being experienced by captive rail shippers since the enactment of the Staggers Rail Act in 1980. Most of KCPL's electric generation is provided by four coal-fired power plants, each of which, until recently, was dependent upon a single railroad for the delivery of its coal supply. As in the case of PEPCO, KCPL did not become a captive shipper by design. Each of its facilities was constructed prior to the existence of the Staggers Act.

In an effort to protect its customers against escalating rail transportation rates, KCPL filed with the Interstate Commerce Commission a complaint against rail rates being charged to deliver Powder River Basin coal to the KCPL Iatan Station. The rail rates for delivering coal to Iatan have risen 47 percent, or almost $11 million on an annual basis, since the enactment of the Staggers Act. This 47 percent increase in rail rates was imposed over a period of time when the Rail Cost Adjustment Factor—calculated by the ICC to measure increases in rail costs—increased only 27 percent. Thus, the rail rate increase to KCPL was 73 percent greater than the rate of railroad cost increases, as indicated in the Rail Cost Adjustment Factor.[5] Yet, the ICC determined the rate to be "reasonable" by asserting among other things that the carrier involved—the Burlington Northern—had not yet achieved revenue adequacy.[6]

KCPL recently has begun to enjoy rail competition at one of its previously captive plants. As a result of this competition, the line haul rates quoted to the non-captive Hawthorn plant are some 20 percent lower than the rail rates quoted to the captive Iatan Station even though the Hawthorn plant is some 60 miles more distant than Iatan from the coal source. KCPL estimates that shipper captivity at Iatan is costing KCPL customers some $4 to $6 million per year.

Iowa-Illinois Gas and Electric Company generates 59 percent of its electricity from coal-fired generation facilities, each of which receives coal exclusively by rail and all of it from mines served by a single railroad. The company's Riverside Generating Station experienced a 50 percent increase in its coal haulage rates by the Burlington Northern from 1980-1984.

Perhaps the most egregious case of captive shipper abuse has been suffered by the Arizona Electric Power Cooperative (AEPCO), a rural electric cooperative that provides power in Arizona and California.

Beginning in the early 1970's, following the OPEC oil embargo, AEPCO undertook an ambitious conversion program, including the construction of two 175 Mw coal-fired units at Cochise, Arizona. Coal for the Cochise units comes from the Mentmone Mine near Gallup, New Mexico, pursuant to a supply agreement with Carbon Coal Company which runs until 1994. AEPCO's agreement with Carbon, in turn, makes it captive to the only two railroads that combine to provide service to Cochise: the Santa Fe and the Southern Pacific. There are no inland waterways or coal slurry pipelines remotely adjacent to either Gallup or Cochise, and the coal volumes and numerous logistical problems rule out motor carriage as a potential alternative.

In 1973, AEPCO received a rail rate quotation of $5.80 per ton, a rate substantially higher than those in effect on other similar movements. A year later, despite the fact that tonnage had increased dramatically, the railroads raised their quoted rate to $7.04 per ton. After two years of unproductive negotiation, AEPCO filed a complaint with the ICC in 1977, seeking prescription of a rate of $4.67 per ton, which AEPCO believed to be a reasonable maximum based upon prevailing rates for comparable movements. The railroads countered with a demand for an even higher rate of $8.64—over twice the cost of service—which the Commission quickly approved. Rates then continued to rise through 'ex parte" general increases approved by the Commission until, by April 1980, they had reached $12.30 per ton.

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[4] Potomac Electric Power Company v. *Baltimore & Ohio Railroad*, Docket 37886; *Potomac Electric Power Company* v. *Baltimore & Ohio Railroad*, Docket 37872.

[5] The Rail Cost Adjustment Factor is calculated by the ICC based on data provided by the Association of American Railroads (AAR) and actually reflects changes in the prices railroads pay for goods and services, not the changes in the actual costs incurred by the railroads.

[6] Supension Case No. 71003, Increased Rates On Coal, Powder River Basin, Wyo. To Iatan, Mo., decision served April 13, 1983.

In May 1980, AEPCO filed a second complaint challenging the $12.30 rate. An administrative law judge found the rate unlawful to the extent it exceeded $10.88 per ton, and the carriers were ordered to reduce their rates and pay reparations. In 1982, however, the full Commission reversed this decision and vacated the ALJ's order. While it later confessed error and reinstated AEPCO's complaint, it never reinstated the ALJ's decision. Today, over five years after filing its complaint against the $12.30 rate, AEPCO is back before the Commission seeking a reasonable rail rate. Meanwhile, the railroads 'charges have continued to rise, and now stand at $15.38 per ton, some 173 percent higher than the 1977 rate of $5.80—a rate which AEPCO felt the evidence showed was too high even then.

When placed alongside charges on other Western unit train movements, the rate charged AEPCO by the railroads is over 1/3 higher than most rates on similar movements, and almost double others. Moreover, when one considers the rates AEPCO likely would be paying if it had access to effective, competitive transportation alternatives, the overcharged permitted under current ICC policies takes on truly incredible proportions. Rates recently negotiated between coal shippers and carriers in a competitive atmosphere have come in at between 12 and 14 mills per ton-mile. The current AEPCO rate is over 30 mills. At 14 mills, the AEPCO movement would produce a rate of $7.07 per ton, less than half the current charge. This suggests that a full $8.76 per ton—upwards of $5.8 million per year—is a monopoly premium, the price of AEPCO's captivity.

If there are any remaining doubts that some captive shipper rates have been excessive since 1980, these doubts should be dispelled by the story of what happened to rail rates when competition finally reached the lower part of the Powder River Basin in Wyoming. After the Chicago & North Western (C&NW) Railroad was allowed to enter the lower part of the Basin to compete with the Burlington Northern (BN)—over the strenuous objections of the BN—coal haulage rates fell dramatically. In early 1985 both carrier submitted bids to the City of San Antonio and the C&NW won. It is interesting to note that the bid of the BN, the existing carrier, was 17 percent below the rate it was then charging the City of San Antonio.[7] The C&NW won with an effective bid of only $19.60 per ton, a reduction of $8.06 per ton (29 percent) over the rate of $27.66 then being charged by the BN. The amount saved on the winning bid—$8.06 per ton—is more than San Antonio is paying for its coal at the minemouth.

But, coal is by no means the only commodity that has been subjected to excessive rates.

2. *Agricultural Commodities*

In June of last year, the potato growers of Southern California—who have been exempt from regulation by the ICC, but are, nevertheless, captive shippers—found that their rail freight rates skyrocketed to unprecedented levels at harvest time. The price of shipping a boxcar load of potatoes to the East Coast markets rose almost 70 percent in a three-week period to a level near $10,000. According to press accounts, the potato growers of Southern California were priced out of their market and had to allow part of their potato harvest to rot in the ground.

In 1980, a group of Montana grain farmers filed a class action suit against Burlington Northern in the U.S. District Court there, challenging rates charged for moving wheat from Montana to Oregon. The District Court referred the case to the ICC which has yet—after five years—to make a final decision in the case. This case is particularly outrageous because in 1981, an ICC Administrative Law Judge found that the farmers were paying rates with a revenue to variable cost ratio of almost 300 percent and that a 200 percent ratio was the maximum reasonable rate to be charged. (The jurisdictional threshold in the Staggers Act for captive shippers is a 180 percent revenue to variable cost ratio.) The ICC has held this ruling in limbo while it tried to decide what test should be applied in determining rate reasonableness. In the meantime, the farmers continue to pay excessive rail rates for grain shipments.

The Colorado Wheat Administrative Committee has reported that the marketing of Colorado grain is being hindered by excessive rail switching charges. Colorado grain shippers wishing to ship their commodity to Kansas City, California, Gulf of Mexico or Pacific Northwest port markets, are faced with switching charges ranging from $300 to $400 per car. This charge, reportedly the highest switching charge of any major grain market in the nation, compares to a $100 per car switching charge that is considered average in most terminal markets.

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[7] San Antonio's repeated attempts to obtain relief at the ICC from these excessive captive shipper rates have thus far been unsuccessful.

The National Council of Farmer Cooperatives represents over 5000 local farmer cooperatives, with a combined membership of nearly two million farmers. In testimony submitted to the Senate Commerce Committee on November 15, 1985 the Council reported the following:

Railroad pricing practices can also determine the market area available to shippers. Today, railroads effectively have the ability to dictate joint rates and routes, reciprocal switching charges, and which shipper can get a contract on what terms. Faces with the inability of captive shippers to negotiate, rail carriers are empowered to determine which farmer cooperatives are able to market their members' grain and which cannot.

The following example illustrates this point. A farmer cooperative faced a reciprocal switching charge of $18 per jumbo hopper car in 1980. The full switching charge was absorbed by the receiving rail carrier and not charged to the shipper. In 1984, the switching charge jumped to $204 per car, a 1,033 percent increase over four years. Moreover, the receiving carrier did not absorb more than the original $18 per car. The cooperative was faced with the dilemma of either paying the remaining $186 per car or not buying any switched grain from its members. The cost of this additional switching charge is about six cents per bushel; yet cooperative profit margins are slim, sometimes only a fraction of a cent per bushel. As a result, the cooperative is unable to buy switched grain from its local elevator-members and is captive to one rail carrier due to excessive switching charges.[8]

3. Other Captive Commodities

In 1984, Amax Chemical Company had to close a phosphate mine in Florida when the Seaboard Railroad imposed a 100 percent rate increase over a three-month period on hauling phosphate rock on a 62 mile run from the mine to a processing plant.

Even the United States Department of Energy (DOE) has felt the impact of unrestrained monopoly pricing power. It has attempted to challenge rates for the shipment of spent nuclear fuel where the revenue to variable cost ratios ranged from 871 percent to 1,222 percent. After being before the ICC since 1981, the DOE has yet to win a final ruling that these rates are unreasonable. To do so, it may have to show that the rates exceed the cost of building a new railroad to ship the spent fuel, as provided in the new coal rate guidelines adopted on September 3, 1985.[9]

II. Specific Problems In the ICC's Implementation of the Staggers Rail Act and the Proposed Solutions Contained in the Consumer Rail Equity Act, S. 477:

The members of Consumers United for Rail Equity and the C.U.R.E. Coalition strongly support the Consumer Rail Equity Act (S. 477 Star Print), whose primary cosponsors are Senators Andrews, Long, Ford, and Stevens. We appreciate their strong leadership and the support of other members of the Senate who are working with them on this legislation, including particularly Senators Exon, Rockefeller, and Gore.

The Consumer Rail Equity Act does not change the fundamental provisions of the Staggers Rail Act. Nor does the Consumer Rail Equity Act reregulate the railroads or return them to the pre-1980 regulatory system. Rather, the Consumer Rail Equity Act attempts to assure that the Staggers Act is enforced in a fair and sensible manner.

The Consumer Rail Equity Act provides a set of procedural rules that will place the burden of proof in shipper disputes where it belongs and will ensure a more reasonable and sensible outcome. As stated in Section 2 of the Consumer Rail Equity Act:

The purpose of this Act is to clarify and reaffirm the intent of Congress that the Railroad Revitalization and Regulatory Reform Act of 1976 and the Staggers Rail Act of 1980 be interpreted and implemented in a manner which will—

(1) revitalize the national railroad system,

(2) ensure adequate service to the public,

(3) provide an opportunity for the nation's railroads to earn adequate revenues under honest, economical and efficient management, and

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[8] Written Comments of the National Council of Farmer Cooperatives Before the Surface Transportation Subcommittee of the Senate Commerce, Science and Transportation Committee, November 15, 1985, at p. 6.

[9] *United States Department of Energy* v. *Aberdeen & Rockfish R.R.*, Docket 38302, order served May 15, 1984 in Docket 37891.

(4) enhance the availability of competitive alternatives, under a balanced approach that encourages and promotes intramodal competition while providing adequate protection for persons served by market dominant rail carriers.

A. The Captive Shipper Issues:

By rule, regulation and decisions in individual cases, the ICC has made it almost impossible for captive shippers to challenge unreasonable rates successfully. Its own administrative law judges have publicly recognized this situation. In a 1984 proceeding, one judge concluded that:

> * * * the Commission, at the present stage of its death throes does not intend, as can be seen from both its actions and inactions, to find a rail rate, no matter how high, to be above a maximum reasonable level.[10]

Before discussing the problems with the ICC's actions it is useful to first review the process Congress established in the Staggers Act for assuring that captive shipper rates are reasonable. Under the Staggers Act, prior ICC approval of rail rates is not required. The railroad simply establishes the rate by filing a tariff rate for the shipper in question. If the shipper believes the rate is excessive, the shipper must petition the ICC for relief.[11]

To challenge the reasonableness of a rate, the shipper must first prove that it is a "captive shipper" by proving that (1) the rate of which the shipper complains exceeds the statutory jurisdictional threshold (180% of the variable cost of the haulage) and (2) the shipper is subject to railroad "market dominance." A railroad has "market dominance" over the shipper when the shipper has no effective alternative to shipping the commodity in question by rail. Having proven that it qualifies as a captive shipper, the shipper—not the railroad—must then prove that the challenged rate is "unreasonable." If the railroad is "revenue inadequate" (or financially unhealthy), the railroad is allowed to charge higher rates to its "captive shippers", but the rate still must be "reasonable".

The Staggers Act established this process for assuring that captive shipper rates are reasonable. However, the ICC adopted the rules and concepts regarding "market dominance", "revenue adequacy", "rate reasonableness" and the elements of proof that must be provided by the shipper. These rules and concepts established by the Commission have effectively nullified the shipper protections established by Congress in the Staggers Rail Act of 1980.

1. Revenue Adequacy

a. Problem:

The ICC's finding concerning the "revenue adequacy" of a railroad is crucial for captive shippers. If a railroad is not revenue adequate, the ICC grants that railroad greater flexibility in setting rates for captive shippers.

Unfortunately, the ICC has adopted a totally unrealistic revenue adequacy test under which no railroad is considered to be revenue adequate. The ICC revenue adequacy standards understate railroad financial health by substantially overstating both railroad investment base and cost of capital. At the October 3, 1985, hearing before the Fossil and Synthetic Fuels Subcommittee of the House Energy and Commerce Committee concerning coal transportation, Mr. Ron Young, Director of the Bureau of Accounts of the Interstate Commerce Commission, admitted that the Commission revenue adequacy test is unique among the nation's state and federal regulatory authorities.

The National Association of Regulatory Utility Commissioners (NARUC) shares this view. As stated in the resolution adopted by the National Association of Regulatory Utility Commissioners in March 1984:

> [The ICC defines] revenue adequacy, on which several pricing freedoms for railroads under the Staggers Act are based, unrealistically, so that no Class I railroads, no matter how profitable, are considered to have adequate revenues, and highly profitable railroads will be allowed billions of dollars in extra rate increases.

The ICC substantially increases railroad revenue adequacy requirements in a number of ways. For example, in making its revenue adequacy determinations, the ICC:

Includes the current cost of debt rather than the generally lower actual cost of debt which the railroads actually pay.

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[10] *The Dayton Power and Light Company* v. *Louisville and Nashville Railroad Company*, No. 38025S, decision served April 11, 1984, at 22.

[11] Of course, a shipper and railroad may enter into a contract at mutually agreeable rates. Contract rates are completely deregulated and the ICC is without jurisdiction to review the reasonableness of such rates.

Since much of the railroads' debt was incurred at interest rates well below those that currently prevail, measuring the funds supposedly required by the railroads to pay debt costs on the basis of current interest rates greatly overstates the railroads true revenue requirements. In reality, when the railroads' actual cost of debt exceeds the current cost of debt, efficient management dictates that the railroad refinance its debt at the lower, current cost.

Permits the railroads to earn a return on deferred taxes as part of their investment base.

Although these funds are acquired without cost to the railroads, they are treated as though costs were incurred, to be reflected in rates. The result is that railroad revenue adequacy requirements are increased.

Determines railroad debt-equity ratios on the basis of current market rather than actually incurred costs and makes no judgment as to the prudency of the railroads' capital structure.

When debt-equity rates are premised on current debt costs, the debt portion of a railroad's capital structure may be understated and the higher-cost equity portion overstated, thus resulting in an unrealistically high cost of capital.

Fails, by its own admission, to include all railroad-related investments, revenues and expenses in the determination.

The ICC has not developed procedures for identifying and including in its revenue adequacy analysis all of the data relevant to a proper measurement of revenue adequacy. As a result, to the extent that revenues which should be included are not included or investments which should not be included are included, the railroads' revenue needs are overstated. It is noteworthy in this regard that CSX Corporation recently announced a write-off of nearly $1 billion of assets, much of which had been included in its investment base for purposes of the ICC's revenue adequacy determinations and therefore was deemed to require a current cost of capital return.

If practices generally applied by utility regulatory commissions were applied, a far more realistic view of the railroad's economic health would emerge. Under the current ICC standards, these railroads will continue to fall far short of revenue adequacy for years to come.[12]

b. Solution:

Section 7 of the Consumer Rail Equity Act [13] requires the Commission to use the same test for determining railroad financial health that is used by public service commissions for determining the financial health of electric utilities. This test, like the present ICC test, compares a railroad's rate of return on investment to the cost of capital. However, the ICC test overstates the cost of capital and overstates the size of the railroad's investment base, which thus materially understates the adequacy of the railroad's revenues. The test in Section 7 corrects these deficiencies. Indeed, Mr. Ron Young, Director of the Bureau of Accounts of the Interstate Commerce Commission admitted in a November 18, 1985 letter to the Honorable Philip R. Sharp that the criteria of the Consumer Rail Equity Act could result in a determination of revenue adequacy for some railroads.

In applying this revenue adequacy test, the Commission must identify revenues, expenses and the investment base reasonably related to providing rail service, and place railroads on the same footing as any other industry by valuing assets at original cost reduced by straight line depreciation. In determining the cost of capital, the Commission shall use actual embedded cost of debt (rather than the present practice of using current cost of debt, which gives a railroad a windfall for all of its debt for which it is paying less than the current rate) and reasonable estimates of the cost of equity, based on the kinds of measurements generally applied by public service commissions.

The revenue adequacy determination is to be made annually and shall allow for adequate public comment on the nonproprietary information submitted by the railroads.

The first two Long-Cannon factors are to be applied in making revenue adequacy determinations.[14] If a railroad is pricing an excess of its traffic at a non-compensa-

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[12] In the words of one of the Commission's own Administrative Law Judges, "[u]sing the present method of arriving at a finding as to which carriers are revenue adequate it will be difficult if not impossible for any carrier to be considered revenue adequate." *Consumers Power Company* v. *Norfolk & Western Ry. Co.*, No. 37854S, decision served 1/18/84, at 9.

[13] Section 7 of the S. 477 Star Print erroneously amends section 10707(a) of title 49, United States Code. Section 7 of the S. 477 Star Print should amend section 10704(a) of title 49, United States Code.

[14] The three Long-Cannon factors that the Commission must presently consider in rate reasonableness proceedings are 1) whether the railroad is carrying traffic at below cost, 2) whether

Continued

tory rate, the revenue shortfall attributable to that practice shall not be considered in deciding whether the carrier is otherwise revenue adequate.

Finally, to assist the Commission in its rate reasonableness proceedings, the revenue adequacy determination is to include a specific Commission finding on the extent of revenues required to achieve or maintain revenue adequacy.

These broader inquiries will not dictate any particular outcome concerning the revenue adequacy of particular railroads. This more reasonable test will, however, result in sensible results that will be credible with the public and with captive shippers.

2. Market Dominance Test

a. Problem:

One of the two elements a captive shipper must prove to gain entry to the jurisdiction of the ICC is the presence of railroad "market dominance." The concept of market dominance was intended to assure that the shipper was indeed "captive" to the railroad and did not have reasonable alternatives available.

Prior to July 31, 1985, the Commission required that the shipper prove that it had no transportation alternative (other railroads, trucks, barges or other transportation alternatives), no "product" alternative (such as, in the case of a utility, using natural gas, fuel oil, nuclear power or even purchasing electricity rather than using coal for electricity generation) and no "geographic" alternative (such as, again in the case of a utility, using West Virginia coal instead of Pennsylvania coal or even foreign coal instead of domestic coal). Moreover, all the railroad had to do was allege the existence of "product" or "geographic" competition and the shipper then had the burden of proving that no such alternative was available.

Captive shippers found the proof of no geographic or product alternative—to prove a negative—particularly burdensome and expensive. The proof of "market dominance" became much more of a barrier to entry into the jurisdiction of the ICC than was envisioned by shippers and, we believe, Congress when the Staggers Act was enacted.

Under the Commission's previous rules, the originator, such as the coal producer, had standing to file a complaint with the ICC concerning the rate being charged for a particular haulage, but the captivity of the haulage was analyzed by the ICC from the shipper's perspective—which means that captivity has normally been determined at the "destination" end of the shipment. An obvious problem arose: a utility plant, for instance, may have transportation alternatives, but the coal mine at the origin may have access to only a single railroad for transportation.

On July 31, 1985, the Commission adopted a new "market dominance" rule under which the shipper must prove that it has no transportation alternative, but the railroad can allege and must now prove that the shipper has a "product" or "geographic" alternative. If the Commission will now apply the new rule fairly and sensibly, properly allocating the burdens of proof could be an improvement for shippers. In addition, the July 31st rule, for the first time, gives captive originators the chance to have their captivity analyzed.

b. Solution:

Section 3 of the Consumer Rail Equity Act codifies the July 31, 1985 market dominance rule, which was recommended to the ICC jointly by the American Paper Institute and the Association of American Railroads.

But a problem may continue to exist under the July 31st rule. Often, a captive "originator," who must operate under a railroad tariff that he believes to be unreasonable, may be unable to market his commodity because of the posted tariff. Thus, a coal producer, grain elevator operator, timber producer or other such "originator" may wish to bring an action at the ICC to contest the reasonableness of the posted tariff. In such a situation, will the ICC consider whether the coal producer has a "product" or "geographic" option? If so, how? The producer has only one product and he is located in only one geographic location. It appears that in such a situation, the only reasonable application of the Commission's new market dominance rule would require the captive shipper to prove only the absence of transportation alternatives. Yet, the July 31st rule is not clear on this point.

Thus, Section 3 of the Consumer Rail Equity Act codifies the July 31st market dominance rule of the Commission, but clarifies that product and geographic alternatives will not be considered when determining whether an originator of traffic is subject to railroad "market dominance."

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the railroad is carrying traffic that contributes only marginally to fixed costs and 3) whether one commodity is bearing too much of the burden of helping the railroad achieve revenue adequacy.

3. Rate Reasonableness Test

a. Problem:

In evaluating the ICC test for judging the reasonableness of a challenged rate, the analysis must focus on the ICC's coal rate guidelines. These guidelines, which were finally issued on September 3, 1985, represent the only systematic effort by the ICC to establish any kind of rate reasonableness test and, if the ICC's own preliminary orders are any indication, will undoubtedly be applied to other commodities besides coal. [See footnote 3.]

The Coal Rate Guidelines provide three alternative "constraints" for captive coal rates.[15] Under all three, the captive shipper has the burden of proof.[16]

First, if the railroad is revenue adequate, the coal transportation rate is constrained in some unspecified fashion. However, in light of the ICC's failure to reform its revenue adequacy test, this type of constraint has little significance. This is particularly true since the ICC has indicated that this constraint—which is not defined—will apply only after the rail carrier has been revenue adequate for several years.[17]

Second, according to the ICC, proof that a carrier's revenue inadequacy is due entirely to management inefficiency will constrain the rate. This test imposes an unprecedented burden of proof on the shipper, especially in light of the magnitude of overstatement of revenue need built into the ICC's current revenue adequacy test. Thus, even if the ICC keeps its promise to allow adequate discovery to the shipper, this will remain a virtually impossible option for proving a rate to be unreasonable.

It is worth mentioning here that in a series of decisions the Commission has all but written out of the law the so-called "Long-Cannon factors." These factors, which were the product of a delicately negotiated compromise during Senate consideration of what became the Staggers Act, were intended to assure that captive shippers do not pay for railroad inefficiencies. However, the Commission has declined to issue rules to implement the factors, crippled the ability of shippers to obtain meaningful discovery, and suggested—as it did in its Coal Rate Guidelines—that the shipper would have to show that inefficiencies were responsible for *all* of a railroad's revenue shortfall before a rate would be reduced.[18]

Third, the new guidelines retain "stand alone cost" as a test for the reasonableness of rates. Stand alone cost is the cost to a shipper or group of shippers of building and operating their own alternate transportation system at today's prices. In other words, if a shipper thinks the quoted rate is unreasonably high, the ICC requires the shipper to demonstrate the cost to build and operate a substitute transportation facility at current prices. While the Commission appears to have clarified some ambiguities in its initial proposal, many important questions concerning the application and implementation of the stand cost constraint are left unanswered.

No matter how these questions are resolved, however, two things are clear. First, only a very few shippers will ever be able to afford to attempt the application of stand alone cost. Second, even for those few who can afford it, only those who are moving tremendous volumes of traffic over densely traveled rail corridors will have any hope of success. In short, the Commission's final coal rate guidelines do not constitute a fair and workable standard of rate reasonableness for captive coal traffic or for any other captive commodity.

b. Solution:

Section 4 of the consumer Rail Equity Act provides that the Commission, within one year after the enactment of the Act, must adopt a rate reasonableness test that applies to all captive commodities (except recyclables that are subject to a statutory rate test). The new test must consider, among other factors, the railroad's need for revenues, the relationship of the rate to the railroad's cost of providing the service (including, where relevant, the fact that the shipper is helping to relieve the railroad's cost burden by supplying cars, paying for loading facilities of the like), and whether and to what extent the railroad's revenue needs require captive shippers to pay rates that exceed the jurisdictional threshold.

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[15] A fourth "constraint," phasing, is only very briefly discussed in the written decision. Even if a rate is found reasonable according to the three other constraints, the Commission says it could still "phase in" the rate to avoid undue disruption. No guidance is offered on how this case-by-case decision will be made.

[16] Ex Parte No. 347 (Sub No. 1), at 32.

[17] The Coal Rate Guidelines adopted by the ICC on September 3, 1985 state that "revenue adequacy is a long-term concept that calls for a company, *over time* to average a return on investment equal to its cost of capital." *Ex Parte No.* 347 (Sub No. 1), at 18 (emphasis in original).

[18] Arkansas Power & Light Co., 365 ICC 983 (1972); *Dayton Power & Light Co. v. L&N* 367 ICC 366 (1983); Petition of Louisville & Nashville R. Co., Docket 38946, decisions served November 24, 1982 and June 23, 1983.

The test adopted by the Commission cannot, however, include the concept of "stand alone cost," which was adopted in the September 3rd Coal Rate Guidelines. Section 4 of the Consumer Rail Equity Act also requires that the Commission must specifically inquire into and make affirmative findings respecting the Long-Cannon factors. Thus, the Commission can no longer avoid implementing the factors, either by suggesting that the complainant has to show that the railroad would be revenue adequate but for its inefficiencies before a rate reduction will be ordered, or by ignoring the third factor altogether—that being whether one commodity is carrying too large a portion of the railroad's revenue needs.

4. Burden of Proof on Rate Reasonableness

a. Problem:

In addition to bearing the burden of proving that it is a captive shipper and, thus, is eligible to have its case heard by the ICC, the captive shipper must also bear the burden of proving the rate is "unreasonable." Despite the fact that the railroad, by definition, possesses monopoly pricing power over any captive shipper challenging a rate as unreasonable, it effectively escape responsibility for justifying its rate. Various administrative law judges at the ICC have commented on the immense burden of proof on captive shippers. For example:

> [I]t appears to this Administrative Law Judge that the complainants are wasting an enormous amount of time, energy and money, proceeding with these cases before a Commission that has clearly shown that it is unable or unwilling to find a complained of rail rate to be above a maximum reasonable level where a carrier is not revenue adequate.[19]

> The amount of detail collected, examined and analyzed by [the complainant] passes belief and total understanding. However, complainant has no other choice unless it is to blindly accept the cost conclusions projected by Conrail. * * * In this regard, [the complainant] made a good faith and extraordinary effort to obtain complete data [on stand-alone costs], but failed because of the enormity of the task.[20]

We believe the burdens of proof must be shared between the railroads and the captive shipper.

b. Solution:

Section 4(a) of the Consumer Rail Equity Act simply requires that railroads and captive shippers share the burden of proof. Once the shipper proves it is captive, the railroad has the burden of proving its proposed rate is "reasonable."

5. Rail Cost Adjustment Factor

a. Problem:

The Rail Cost Adjustment Factor that is used by the Commission today does not effectively reflect cost decreases and productivity gains, but reflects only increases in the prices paid by the railroads for goods and services. The index operates to increase tariff rates when the index increases, but does not operate to decrease tariff rates when the index decreases.

Furthermore, the methodology is based on projections of what costs will be in the coming quarter. If the projections are too high and rail costs subsequently go down, there is no mechanism to remedy, in the following quarter, the effects of the excessive projection. Shippers are confronting this problem right now because on December 20, 1985, the ICC approved as 1.1 percent increase in rates, based in part upon AAR's December 5, 1985, projection that costs for fuel (primarily oil products) would increase 4.9 percent from the last quarter of 1985 to the first quarter of 1986. This determination was made despite shippers' submissions which showed that events after December 5, 1985, particularly the failure of OPEC oil ministers on December 11 to agree to a price or marketing strategy, indicated that fuel prices would actually decline in the first quarter of 1986. The basis for the ICC's failure to rely upon the most recent fuel price data is not clear. Moreover, the ICC has been asked to reconsider its determination, but still has not responded. Nor has the ICC established any mechanism to promptly implement any adjustments in following quarters if, as now appears likely, fuel costs decline and other rail costs do not increase.

b. Solution:

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[19] *Consumers Power Company* v. *Missouri Pacific R. Co.*, No. 37845S, decision served January 18, 1984, at 8 (emphasis supplied).

[20] *Pennsylvania Power & Light Company* v. *Conrail*, No. 38185S, decision served July 18, 1984, at p. 9.

Section 6 of the Consumer Rail Equity Act requires the Rail Cost Adjustment Factor to reflect increases and decreases in actual costs (not just prices paid by the railroads) and productivity gains. Section 6 also requires the ICC to adjust tariff rates down (to the extent they have been previously increased under this index) when the Rail Cost Adjustment Factor declines (as it did for five consecutive quarters in 1984-1985) as well as up when the index increases.

B. The Competitive Access Issues

1. Problem:

Often, a rail shipper's only opportunity for obtaining competition is when railroads will enter joint rate agreements, switching agreements and use of terminal facility agreements at reasonable rates. These historical arrangements between railroads allow efficient routing and movement from one rail system to another where rates or service may be more attractive. Under certain circumstances, the ICC has the power to force the railroads to enter or maintain such arrangements at reasonable rates. Many shippers have alleged that since the enactment of the Staggers Act, the railroads have cancelled or refused to enter such arrangements, or dramatically increased their fees for such arrangements, all with the purpose of reducing competition and increasing their universe of captive shippers.

Early in 1985, the Association of American Railroads (AAR) and the National Industrial Transportation League (NIT League) reached and agreement concerning these "competitive access" arrangements and asked the ICC to implement the agreement as a rule. The agreement established the procedures and circumstances under which the Commission would order or maintain competitive access arrangements. The agreement was premised on the Commission's the existing interpretation of the statutory showing that was required for relief under the Staggers Act competitive access provisions. Many shippers and smaller railroads did not believe that this agreement went far enough to provide any effective relief.

The AAR/NIT League agreement was pending before the Commission throughout 1985. On September 11, 1985, the ICC agreed to issue the AAR/NIT League agreement as a rule. Unfortunately, however, on July 17, 1985, the Commission had issued a decision in *Midtec Paper Corporation* v. *Chicago & North Western Transportation Company*, which substantially changed the legal interpretations that were the basis for the AAR/NIT League agreement. According to NIT League legal documents, the Midtec case "largely cancel[s] out" its compromise with the AAR.[21]

After maintaining for several months that the Midtec decision was consistent with its new rules, the Commission suddenly announced at the November 1st Senate oversight hearings held by this subcommittee, that it was retracting the Midtec decision for further review. Unfortunately, this chronology of events has been all too common at the ICC. Shippers remain concerned that a settled, fair and effective set of rules implementing the Commission's discretionary authority in the area of competitive access remains absent five years after the Congress conferred this authority on the Commission in the Staggers Act.

2. Solution

Section 9 of the Consumer Rail Equity Act changes the Commission's current discretion to order such arrangements to a mandatory direction that the Commission shall order such arrangements when it finds they would be either practicable and in the public interest, or necessary to provide competitive rail service. In addition, Section 9 clarifies some of the standards to be employed by the Commission on exercising this authority.

C. Miscellaneous Provisions

The problems discussed above with regard to revenue adequacy, rate reasonableness, market dominance, the rail cost adjustment factor, the burden of proof on rate reasonableness and competitive access are the principal areas in which the ICC has frustrated the intent and purpose of the Staggers Act. There are, however, several additional problem areas which must also be addressed through legislation.

1. Abandonments

A railroad line (or other facility) that is proposed to be abandoned is typically a line that is of little interest to the abandoning carrier, perhaps because the line is not profitable. However, the facility to be abandoned is often of great importance to the shippers and communities served by the line. Because the impact on a community and its economy can be devastating, an abandonment decision deserves the most careful consideration.

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[21] Motion to Intervene, filed August 15, 1985, *Midtec Paper Corporation* v. *ICC*, (D.C. Circuit).

The Consumer Rail Equity Act makes no change in substantive law with respect to abandonments. The railroad must continue to carry the burden of proving that (1) the line to be abandoned is uneconomic and (2) the abandonment is in the public interest.

Three procedural changes are made by Section 10 of the Consumer Rail Equity Act. First, in order to clarify that abandonment proceedings are not to be instruments in a war of attrition, a railroad must wait one year after denial of an abandonment application by the Commission before refiling to abandon the same facility, unless it can show that circumstances have materially changed since the unsuccessful application was denied. Second, if the abandonment is contested, the Commission must allow a hearing on the impact of the proposed abandonment on community or rural development (the standard set by current law) in one or more of the communities affected. The Commission may contract with outside parties to preside at the hearing, and the railroad proposing the abandonment must pay the expenses of the hearing. Third, the financial data used in deciding whether the facility is economic must be based on the actual revenues and actual costs of operating the facility at issue, rather than system-wide or industry-wide averages.

2. Exemption Authority

The Commission is directed in 49 USC § 10505 to pursue exemptions from regulation where the regulation is not necessary to carry out the transportation policy set forth in section 10101a, and is either (a) of limited scope or (b) no longer needed to protect shippers from abuse of railroad market power. Section 8 of the Consumer Rail Equity Act would provide that an exemption "may" be issued if the Commission finds there is no market dominance (within the meaning of section 10709, as amended by Section 3 of the bill) over the transportation involved in the exemption. This section also provides that the Commission should consider whether persons other than shippers (including receivers and consumers) require protection from abuse of railroad market power sufficiently to deny issuance of an exemption.

These changes are intended to prevent the use of the exemption power in circumstances where competitive forces do not exist to effectively discipline railroad monopoly power.

3. Review of State Decisions:

Section 11 of the Consumer Rail Equity Act will streamline procedures respecting state jurisdiction over intrastate rail transportation. The fundamental goal of present law is unchanged: a state commission exercising regulatory jurisdiction over intrastate rail transportation pursuant to state law must do so consistently with the provisions of Federal law governing interstate rail transportation.

This section would simplify the achievement of this goal by eliminating the time-consuming process of Interstate Commerce Commission certification that a state's law, rules and practice are consistent with the Federal law. Instead, this section eliminates bureaucratic delays and protects the dignity of the state process by relying upon ICC review of state decisions to assure uniformity of implementation. The ICC's review is limited to an appellate function analogous to that of a Federal court of appeals reviewing an Administrative agency decision under the Administrative Procedure Act, including a provision for remand of any inconsistent decision to the state agency. The ICC is given 120 days to dispose of any appeal from a state agency decision, thus assuring prompt and effective review.

4. Rail Transportation Policy

Section 5 of the Consumer Rail Equity Act expands one of the fifteen national goals to be achieved in the implementation of the Staggers Rail Act of 1980, to provide that the Commission must consider the competitive positions of domestically produced coal and other commodities. The bill also clarifies another of the national goals to clarify that rates must be reasonable even if a railroad is revenue inadequate.

5. Transitional Provisions:

Section 12 of the Consumer Rail Equity Act addresses one transitional issue. Section 229 of the Staggers Rail Act provides that any rate not challenged within 180 days after enactment of the Act, or any rate so challenged and found by the Commission to be either reasonable or not subject to market dominance, would be deemed forever lawful and not subject to challenge. Over 800 so-called "Section 229" challenges were filed, very few if any of them successfully, and some rates were not challenged because they were covered by a contract entered into or in effect during the 180 day period.

This section will not affect any railroad contract covering the tariff in question. However, many of these tariffs could become operative again at the end of the contract period. Any rate not challenged under Section 229 because of a contract can be reviewed under this bill's standards. The contract itself and the rates under the contract are to remain in full force and effect. Only the underlying rate which will apply on expiration of the contract is subject to challenge.

III. CONCLUSION

Mr. Chairman and members of the subcommittee, we thank you for this opportunity to present our case to you. We urge you to consider and mark-up the Consumer Rail Equity Act as soon as possible. We stand ready to provide any additional information or assistance which could be helpful to the subcommittee.

ATTACHMENT 1.—C.U.R.E MEMBERSHIP LIST

Alabama Electric Cooperative, Inc.
Algona Municipal Utilities.
Allegheny Power System, Inc.
Amax, Inc.
American Electric Power Company.
Andalex Resources, Inc.
Arizona Electric Power Cooperative.
Arkansas Electric Cooperative Corporation.
Atlantic City Electric Company.
Baltimore Gas & Electric.
Blue Diamond Coal Company.
Carbon Coal Company.
Carolina Power and Light Company.
Central Illinois Light Company.
Central Power and Light Company.
City of Austin ELectric Utility.
City of Lakeland, Florida/Orlando Public Utilities Commission.
City Public Service Board of San Antonio.
Cleveland Electric Illuminating Company.
Consolidation Coal Company.
Cyprus Coal Company.
Dairyland Power Cooperative.
Dayton Power and Light Company.
Delta Coals, Inc.
Department of Utilities, City of Colorado Springs.
Dixie Fuel Company.
Drummond Coal Company, Inc.
East Kentucky Power Cooperatives, Inc.
Electric Fuels Corporation.
Elk River Resources, Inc.
Grand River Dam Authority.
Heartland Consumers Power District.
Houston Lighting & Power Company.
Illinois Power Company.
Indianapolis Power & Light Company.
Iowa Public Service Company.
Iowa-Illinois Gas and Electric Company.
Jim Walter Corporation.
Kansas City Power and Light Company.
Los Angeles Department of Water & Power.
Lower Colorado River Authority.
Madison Gas and Electric Company.
Metropolitan Edison Company.
Minnesota Power and Light Company.
Missouri Public Service Company.
Municipal Electric Systems of Oklahoma.
Nebraska Public Power District.
NERCO Coal Company.
Ohio Edison Company.

Oklahoma Gas and Electric Company.
Omaha Public Power District.
Otter Tail Power Company.
Peabody Holding Company.
Pennsylvania Power and Light Company.
Platte River Power Authority.
Portland General Electric Company.
Potomac Electric Power Company.
Public Service Company of Oklahoma.
Public Service Electric & Gas Company.
Randall Fuel Company, Inc.
Royal Fuel Company.
Salt River Project.
Savannah Electric & Power Company.
Shannopin Mining Company.
South Carolina Electric & Gas Company.
South Carolina Public Service Authority.
South Mississippi Electric and Power Association.
Southern California Edison Company.
Southern Company.
Southern Indiana Gas & ELectric Company.
Tampa Electric Company.
Union Electric Company.
Western Farmers Electric Cooperative.
Wisconsin Electric Power Company.
Wisconsin Power & Light Company.
Wisconsin Public Service Corporation.

ATTACHMENT 2.—MEMBERS OF THE C.U.R.E. COALITION

Alabama Coal Association.
American Bakers Association.
American Feed Industry Association.
American Public Power Association.
Arkansas River Power Authority.
Association of Illinois Electric Cooperatives.
Association of Louisiana Electric Co-ops.
Arizona Agricultural Chemicals Association.
Bennett Tree Farms, Inc.
Buffalo Electric Cooperatives.
Cedar Falls Utilities.
Central Louisiana Electric Company, Inc.
Coal Exporters Association of the United States, Inc.
Colorado Rural Electric Association.
Consumer Energy Council of America.
Consumer Federation of America.
Cooperative Power Association.
Eastern Coal Transportation Conference.
Edison Electric Institute.
Electric Power Associations of Mississippi, Inc.
Ethyl Corporation.
Eugene F. Burrill Lumber Company.
Florida Phosphate Council.
Gulf Ports Association.
Houston Port Bureau, Inc.
Illinois Farmers Union.
Indian Electric Cooperatives, Inc.
Indiana Municipal Electric Association.
Indiana Statewide Association of Rural Electric Cooperatives, Inc.
International Minerals & Chemical Corporation.
Jackson Electric Cooperative.
Jump River Electric Cooperative, Inc.
Kansas Electric Cooperative, Inc.
Kansas Gas and Electric Company.
Louisiana Department of Natural Resources.
Louisiana Municipal Association.
Louisiana Police Jury Association.

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Mining and Reclamation Council of America.
National Association of Regulatory Utility Commissioners.
National Association of State Utility Consumer Advocates.
National Coal Association.
National Consumers League.
National Council of Farmer Cooperatives.
National Farmers Organization.
National Farmers Union.
National Grange.
National League of Cities.
National Rural Electric Cooperative Association.
Nevada Attorney General Consumer Advocate.
North Dakota Public Service Commission.
North Dakota Rural Electric Cooperative.
North Dakota Wheat Commission.
Ohio Consumers Association.
Ohio Rural Electric Cooperative, Inc.
Pacific Northwest Waterways Association.
Pennsylvania Rural Electric Association.
People's Co-op Power Association.
Petit Jean Electric Cooperative Corporation.
Price Electric Cooperative, Inc.
Riley Whittle Inc.
Rocky Mountain Farmers Union.
Siskiyou Shippers Association.
Sunkist Growers, Inc.
Surface Mining Research Library.
Tennessee Valley Public Power Association.
The Rail Action Corporation [TRAC).
Transco Coal Company.
United Auto Workers.
United Small Coal Operators, Inc.
United Steelworkers of America.
Universal Forest Products, Inc.
U.S. Conference of Mayors.
Utilities Department, City of Lafayette, Louisiana.
Vernon Electric Cooperative.
Virginia Electric and Power Company.
Western Coal Traffic League.
West Virginia Surface Mining & Reclamation Association.
Women Involved in Farm Economics.
Youth for Energy Independence.

Attachment 3

UTILITIES INCLUDED IN DRAFT DOE STUDY
Pre-Tax Return on Investment (ROI)

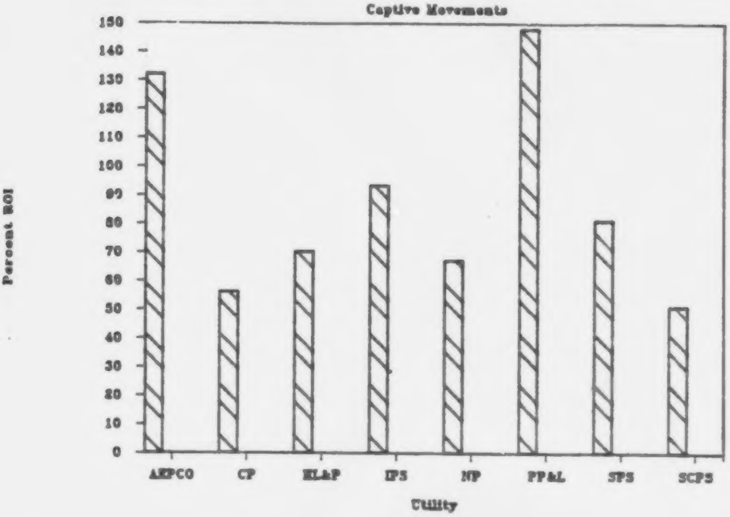

TABLE 1

Estimated Pre-Tax Return on Railroad Investment Used to Provide Service to Utilities with Captive Coal Movements (1984): 8 Utilities Included in the Draft Department of Energy Study

Utility	Railroad	Pre-tax Return on Investment Used in Captive Utility Coal Movement
Arizona Elec. Power Co-Op	Santa Fe	132%
Consumers Power	C&O	56%
Houston Lighting & Power	BN	70%
Iowa Public Service	BN	93%
Nevada Power	UP	67%
Pennsylvania Power & Light	Conrail	148%
Southwestern Public Service	BN	81%
South Carolina Public Service Authority	Seaboard	51%

ADDITIONAL UTILITIES STUDIED BY EEI
Pre-Tax Return on Investment (ROI)

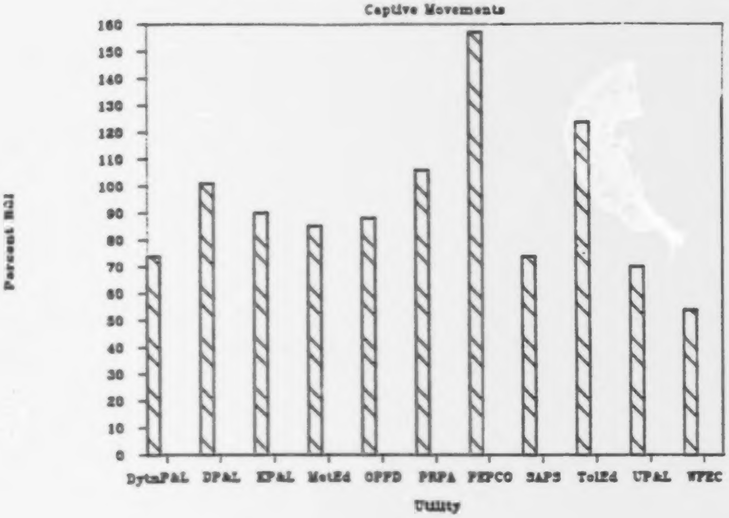

TABLE 2

Estimated Pre-Tax Return on Railroad Investment Used to Provide Service to Utilities With Captive Coal Movements (1984): 11 Additional Utilities

Utility	Railroad	Pre-Tax Return On Investment Used in Captive Utility Coal Movement
Dayton Power & Light	Seaboard	74%
Delmarva Power & Light	Conrail	101%
Kansas Power & Light	UP	90%
Metropolitan Edison	Conrail	85%
Omaha Public Power Authority	BN	88%
Platte River Power Authority	BN	106%
Potomac Electric Power Company	B&O	157%
San Antonio (City of)	BN	74%
Toledo Edison	N&W	124%
Utah Power & Light	Denver Rio Grande	70%
Western Farmers Elec. Co-Op	BN	54%

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS

Question 1. You have indicated that captive shippers do not have recourse at the ICC. Do you know upon what basis relief has been denied?

Answer. The short answer to this question is that the ICC has failed to properly carry out the captive shipper protections of the Staggers Rail Act. The Act provides that if a captive shipper's rate exceeds a statutory threshold (currently 180% of the railroad's variable cost of providing the service), then the shipper may petition the ICC to determine whether the rate is reasonable. While many shippers have succeeded in demonstrating that they are captive and pay rates in excess of the statutory threshold, the ICC can identify just one instance in which a challenged rate was in fact found unreasonable and ordered reduced—but that case was subsequently reopened and is still pending at the ICC, now to be reconsidered under the Coal Rate Guidelines. (*Coal, Wyoming to Redfield, Ark., Docket 37276.*) The ICC's record in captive shipper cases is summarized in Chairman Gradison's letter of January 10, 1986 to Subcommittee Chairman Packwood, in response to questions posed for the oversight hearings before the Subcommittee on November 1, 1985.

Several Commission mistakes stand out as major contributors to this poor record. First, a principal reason for ruling against shippers in these cases—in some cases, the *only* reason—has been that the railroad in question was "revenue inadequate." We captive shippers need healthy railroads and acknowledge that we will have to pay more than competitive shippers to achieve that goal. The Commission, however, has developed a unique, simplistic revenue adequacy test that substantially overestimates railroad financial needs and produces unrealistic conclusions. For instance, in its most recent revenue adequacy determination, the Commission found that Conrail was earning a better return on investment than the Norfolk Southern railroads. The Commission has now admitted, after years of challenge by captive shippers, that its test is badly flawed but it has not corrected its test. Cases are still being tried using the flawed test.

Second, the Commission has ignored the Long-Cannon amendment, which was a delicately negotiated compromise that materially aided in the passage of the Staggers Act in the Senate. The amendment was intended to ensure that captive shippers do not subsidize railroad inefficiencies. However, the Commission's standard for obtaining relief under the amendment places such an inordinate burden on shippers that relief is effectively denied.

Third, the Commission has adopted as its primary rate reasonableness test a concept known as "stand-alone cost." Commissioner Branko Terzic of the Wisconsin Public Service Commission testified before the Subcommittee on Surface Transportation on Feburary 21, 1986, that to his knowledge "stand-alone cost" has been discarded as a test of monopoly ratemaking by every other regulatory agency that ever considered it. (Page 131 of transcript.) While no rail rate should ever exceed stand-alone cost, it does not follow that a rate set at the stand-alone cost ceiling is reasonable. Because the ICC's test is exceedingly complex and expensive to apply, and because it does not realistically represent a constraint on the ability of a monopoly rail carrier to charge excessive rates, a more sensible rate reasonableness test is needed.

To what extent would the result of specific cases have been changed by your legislation?

It is difficult to review a completed case and predict with any certainty how its outcome might have been different. S. 477 would at least provide shippers with an opportunity to protest a high rate in a more balanced regulatory environment, and should force the Commission to provide some restraint on railroad monopoly rates.

Specifically, S. 477 would provide a more realistic revenue adequacy test and force consideration of the Long-Cannon amendment in determining revenue adequacy. Thus, a shipper would not be forced to pay rates higher than those needed to maintain a viable, efficiently managed railroad. The bill would also shift the burden of proof to the railroad in rate cases, lessening the railroad's incentive to withhold information needed for a proper evaluation. Finally, the Commission would be obligated to develop a more workable rate reasonableness test, one that included some consideration of the actual costs and efficiency of the carrier rather than simply the costs incurred by a hypothetical "stand-alone" competitor.

Question 2. S. 477 includes certain provisions dealing with market dominance. Are those provisions not in large part codifications of the market dominance regulations recently adopted by the ICC?

Answer. Yes. The revised, "Star Print," version of S. 477 incorporates the market dominance rules approved last year by the ICC. S. 477 (Star Print) would also prevent the Commission from considering geographic competition at the destination when considering the captivity of the origin. This simply allows a producer who is being foreclosed from participation in a market by excessive rail rates the opportunity to make his case to the Commission.

Question 3. You have argued against ICC's coal rate guidelines and instead support a provision which would direct the ICC to initiate a new proceeding and arrive at new standards. Do you not believe that the Commission has thoroughly reviewed this issue over the last several years and arrived at the best available constraints?

Answer. While many years have been spent in rate reasonableness rulemaking proceedings, we must disagree that the issue has been "thoroughly reviewed." A thorough review would not result in a rate reasonablenes test that is unique, little understood, complex and expensive to apply, and ignores something every other regulatory body closely scrutinizes: the *actual* cost of service. Captive shippers do not believe that this is the best that the Commission can do.

What specific standards would you hope would be approved?

S. 477 (Star Print) does not mandate a particular rate reasonableness test, as the earlier version of the bill did. We do ask that in developing a new rate reasonableness test, the Commission provide that the carrier's actual cost of service, and the relationship between that cost and the rate being challenged, be considered. By this we certainly do not intend that the Commission engage in the kind of cost-based ratemaking that electric utilities face, but only that rail rates substantially above the carrier's cost of providing service be carefully scrutinized. Otherwise, how is the ICC to determine if one captive commodity is disproportionately subsidizing the railroads revenue requirements? How this is to be specifically accomplished is left for the Commission to decide in the context of a notice and comment proceeding.

The Commission is also given the discretion to include other considerations, such as how best to serve the needs of the small shipper.

Revenue adequacy will continue to be an important consideration in rate cases, but under the provisions of S. 477 (Star Print) it will be accurately measured.

Question 4. S. 477 includes provisions dealing with joint routes and competitive access. Are you not satisfied with the recently adopted competitive access regulations, and if not, why not?

Answer. At hearings on June 5, 1986 before the Subcommittee on Commerce, Transportation and Tourism of the House Energy and Commerce Committee, ICC Chairman Gradison conceded that no petitions for relief have been filed under the ICC's new competitive access rules. Shippers obviously do not believe that those rules will assure opportunities for rail to rail competition. Moreover, the usefulness of the rules is further clouded by the Commission's recent *Midtec Paper Company* case which according to then Chairman Taylor's dissent would require a shipper to prove all the elements of a rate reasonableness case before prevailing on a competitive access petition.

How are the provisions in S. 477 different from those regulations?

The ICC's regulations are essentially a detailed statement of how it will exercise discretionary authority in certain circumstances to order reciprocal switching, or prohibit the cancellation of a joint rate. S. 477, on the other hand, makes the Commission's reciprocal switching authority mandatory rather than discretionary, and does the same for the Commission's discretionary authority over joint use of terminal facilities, which is not covered by the regulations. The bill's proportional rate authority is intended to eliminate the opportunity for a rail carrier to reap the financial benefits of cancelling joint rates for anticompetitive purposes, and should operate to prevent such cancellations, rather than force shippers to hope for an after the fact remedy from a Commission that takes years to act.

Question 5. The ICC has indicated that the changes made by S. 477 to its existing exemption authority would prevent exemptions that would be appropriate. How do you respond to this concern?

Answer. The Commission's view of what exemptions are "appropriate" has been soundly criticized in the courts, which have reversed two of the Commission's major exemptions as beyond the authority of the current law. In the Coal Export Exemption case, for instance, the Court of Appeals said that the Commission: "sought to maximize railroad revenue with no reference to the actual revenue needs of the carriers involved or the size of the revenue gains they would likely receive from the exemption, or the degree to which needed revenue gains would be disproportionately subsidized by one group." *Coal Exporters Ass'n. v. ICC*, 745 F.2d 76, 98 (D.C. Cir. 1984)

It is also worth pointing out that the piggyback or intermodal exemption which is touted by the ICC as being "so successful" (see Chairman Gradison's Statement on S. 477 to the Subcommittee, February 21, 1986 at 20), probably deserves more reveiw. At hearings before the House Subcommittee on Commerce, Transportation and Tourism on February 6, 1986, the President of the Association of American Railroads testified that piggyback traffic pays on average just 112 percent of variable cost while railroads must on average charge about 152 percent of variable cost to make an adequate rate of return. (Page 144 of transcript.) The difference, of course, must be made up by captive shippers and consumers, who often pay rates well over 200 percent of variable cost. We can accept that responsibility only if the Commission is properly implementing the Long-Cannon amendment to make sure that 112 percent of variable cost is the best that railroads can do on piggyback traffic. The point is not necessarily that the piggyback exemption should not have been granted, but rather that the successful implementation of the exemption authority depends in large part on the Commission's attention to *all* of its responsibilities under the Act.

The Commission's view of when an exemption is "appropriate" should therefore not control Congress's judgment as to whether the exemption authority has been properly exercised. We believe that without sensible guidance from Congress, the Commission will continue to demonstrate a fundamental misunderstanding of its exemption authority. Congress intended that the Commission should have the freedom to deregulate traffic or transactions only in circumstances where the marketplace would effectively discipline railroad abuses of market power. The changes proposed by S. 477 are meant to reassert that intent and prevent the Commission from continuing to misuse its exemption powers.

QUESTIONS OF SENATOR SYMMS AND THE ANSWERS

Question 1. In the past five years, since enactment of the Staggers Act of 1980, in how many instances has the interstate Commerce Commission found that a complaining shipper has been the subject of unreasonable discrimination?

Answer. We know of no instance in which a captive shipper has been found to be the subject of unreasonable discrimination.

Question 2. How soon after the filing of a contract must a shipper, believing itself the subject of unreasonable discrimination, petition the ICC for disclosure of the contract's terms or be forever barred from learning its contents?

Answer. The Commission's regulations currently provide that a shipper must file its complaint and discovery request within 18 days after the contract itself is filed. See 49 C.F.R. § 1039(d).

Question 3. How will such a shipper even have knowledge of the contract's filing within this short period of time?

Answer. The ICC's Contract Advisory Service compiles and disseminates to interested parties brief summaries of the non-confidential terms of contracts filed for approval. See 29 U.S.C. § 10713(m). As is discussed in the answer to the next question, the usefulness of these summaries for testing for unreasonable discrimination is a matter of dispute.

Question 4. Isn't the most effective mechanism for avoiding unreasonable discrimination the posting and publication of rates?

Answer. Strictly speaking, the answer to this question is "yes." In response to widespread complaints about discrimination, the original Interstate Commerce Act of 1887 relied upon the publication of rates in tariffs, and prohibitions against charging a rate not published in a tariff, to remedy the problem. (24 Stat. 379). Thus, for nearly a century, this had been the law's basic protection against unjust discrimination in rail rates.

In 1980, however, Congress concluded in the Staggers Rail Act that within certain limitations, rail carriers would be permitted wide latitude to discriminate among shippers. As part of this judgment, Congress determined to allow railroads and shippers to enter into contracts. To encourage this practice, the law protects the confidentiality of the more sensitive terms of contracts, particularly rates. At the same time, Congress provided a mechanism for shippers, particularly small shippers and shippers of certain agricultural and forest products, to petition the ICC and complain that they have been subjected to *unjust* discrimination.

Few commercial contracts are publicly disclosed, and some degree of confidentiality of sensitive terms such as rates in railroad haulage contracts is essential if contracting is to work as Congress intended. If railroads cannot negotiate in confidence, they will be loath to offer shippers special rates based on normal commercial considerations.

At the same time we appreciate that many shippers especially small shippers, are complaining that the contract summaries published by the Commission are so terse or vague as to be often meaningless, and that shippers with standing to complain about unreasonable contract discrimination face an all but insurmountable burden before they can obtain discovery of the more sensitive terms. We support the efforts of those who would seek to ease this burden, and are working with a number of these shippers to that end. Most shippers have reservations, however, that public disclosure of all contract terms in the ordinary course is the answer, for that could effectively impair the meaningful negotiations that are essential to the Staggers Act contracting authority.

Question 5. Haven't the Canadian National and Canadian Pacific, which had the right to negotiate contract rates long before United States railroads did, been obliged to post and publish their contract rates?

Answer. Consumers United for Rail Equity and the C.U.R.E. Coalition have not gathered information on the Canadian system.

* * * * * * *

Senator Symms also posed a number of questions regarding rates associated with the use of shipper-owned equipment. Consumers United for Rail Equity and the C.U.R.E. Coalition have not identified the shipper-owned equipment issues as one of the issues that are the focus of our efforts in supporting the Consumer Rail Equity Act. Thus, we have never surveyed our members on this issue and cannot respond to the specific questions submitted by Senator Symms.

We would note as a general proposition, though, that we understand Senator Symms' concerns. Many electric utilities have purchased the coal hopper cars used to ship coal by rail to their power plants, and some have paid for or contributed to the cost of improving or constructing rail spurs or loading and unloading facilities. Often these shipper financed improvements have not been adequately reflected in the rates charged by railroads.

In our case, a balanced and properly implemented system of captive shipper rate regulation, such as that envisioned by S. 477, may be the best answer. S. 477 would require that the railroad's actual cost of providing the service be part of the consideration of whether a rate is reasonable. Thus, any contributions by the shipper which relieved the carrier of part of its cost of providing the service would be considered in a rate reasonableness determination.

This solution would not be readily applicable to boxcar traffic, which is deregulated under a Commission exemption and which generally is charged rates below the Commission's jurisdictional threshold due to truck competition.

Senator PACKWOOD. We will take Mr. Dempsey's testimony first, and then the questions for both of you.

Mr. DEMPSEY. I am accompanied by J. Thomas Tidd, who is my vice president for law. The committee has heard me before several times on this general subject. You know what our position is with respect to the Staggers Act.

The industry was, as has been pointed out, in a state of chaos in 1980, with 22 percent of our trackage under bankruptcy jurisdictions.

The CHAIRMAN. Could you speak more clearly?

Mr. DEMPSEY. Yes, thank you. I will; if not more clearly, at least more loudly.

I will not recount all of that history. It is true in my judgment that the Staggers Act has been a most significant element in partial rejuvenation of the rail system, and we are anxious that it be retained in its present form and that it not be modified.

There have been problems, of course. We have tried to work them out with the different shipping interests. We have worked out agreements with the National Industrial Traffic League, the Chemical Manufacturers Association, the American Paper Institute and the National Grain & Feed Association on questions of joint rate cancellation, reciprocal switching cancellations, market dominance and, finally, disclosure of contracts.

In that connection, Mrs. Kassebaum, I would say that the agreement that we arrived at with National Grain & Feed is designed to address the problems that you raised. If there is any elasticity in there that would allow any kind of chicanery to go on, why we would be most grateful for any kind of amendments that the Commission would make and the committee would make in those rules, because we really did want to address that problem. As you know, it is an issue which has divided the agricultural community, and so it has not been an easy matter to put together but I hope we have done it.

We have not, unhappily, been able to arrive at an accord with the utility industry and the coal industries, and that is why we are here, of course. I will not discuss the CURE bill in particular because I do not have time, but all of our observations on it are contained in the record.

I would say, just as an overall matter, that it is not fine tuning. It would tune the industry, in our judgment, right off the keyboard. It is a major and radical revision of the Staggers Act, and as CARS, a group of 350 shippers opposed to any revisions has said, it would in their judgment put us back into an era of regulation that would be more onerous than we had even before Staggers.

I would just say a word about whether there is need for this legislation, noting specifically the matter of coal. We have done this before. The detail is in the record.

I would have thought that behind all of this effort would be some sort of explosion of coal rates, some sort of showing of abuse by the railroads who are alleged to have a monopoly over captive coal shippers. That is not a matter of record and cannot be made a matter of record because it is not the fact on average. The CURE witness at the last hearing before the House acknowledged this. On average, coal rates have gone up at a very moderate level, as you have heard testimony already today, about 0.4 percent a year since Staggers over the rate of inflation. Indeed, in the last three years they have declined in real dollar terms.

Now, the point was made by Senator Rockefeller with respect to cost, and it is a perfectly valid point, and I would have thought that the fact that the improved financial health of the industry due to increased efficiency would have been a good thing rather than a bad thing. If that was the suggestion, we had hoped that the increased flexibility that we would have would enable us to increase our efficiency so that we would not have to improve our profitability by pouring on huge rate increases, and that is what has happened.

As to coal in particular, though, if you will look at the revenue per ton mile data you will see that for the most part these increases in productivity have been passed on to the consumer, because in terms of revenue per ton mile, because of our increased length of hauls during this period of time, our revenue has actually dropped by a very substantial percent.

The other way to look at it is revenue in relation to cost, and if you look at the ICC data in that respect you will find that on average coal revenue in relation to, variable cost is 146 percent. That is less or the same as five or six, I have forgotten which, of our other major commodities, so coal does not stand out in any respect in relation to cost and revenue as a commodity that is being dealt with unduly harshly.

It has been said in the past those are average figures. You have to look at specific examples. I went to Secretary Hodel before he became famous on this subject, when he was Secretary of Energy, and I said the things that your department is saying about Staggers really cannot withstand scrutiny in terms of what has actually happened.

He said, well, what has happened? I said here are our data. He said fine, I will give them to EEI. I will give them to National Coal Association and let them respond, and then I will give you a shot at what they say. I said fine.

EEI came up with, I think, eight cases that they considered were horrible cases, and the Secretary told his staff to look at those cases. They did, and they concluded there was no evidence in any of those cases of abusive rate action by the railroads.

Secretary Hodel then said that publicly to the coal industry or wrote it to the head of EEI and to the National Coal Association. The EEI has come up with, I guess, 11 more cases.

They are analyzed in detail in our statement. They have been analyzed by the Interstate Commerce Commission. You have all of that before you, and the fact of the matter is that if you look at averages or if you look at particular cases there is simply no evidence that warrants any kind of modification of the Staggers Act based upon what has been happening to coal rates in Staggers.

Let me just say a few words in the time that I have remaining about some of the general issues that are covered by the CURE bill.

Let me begin with—and I may have to end with it because my time may run out—the question of revenue adequacy, because that seems to be an issue that is given a great deal of attention.

Let me start out by saying that the new CURE bill represents a major advance over the old CURE bill because it finally accepts the notion that the Commission was correct in adopting the current cost of capital as the test for revenue adequacy.

I have never been able to understand why the utility industry would take a different position because they argue before every regulatory commission that the cost of capital is the appropriate standard for measuring whether or not an enterprise is making enough money over the long run. It is self-evident if an enterprise is not earning over the long run the current cost of capital, it has to go out of business or it has to change its operation so that it can, because otherwise it cannot attract the capital that is necessary for it to stay in business.

That leaves several subsidiary questions. They are highly technical. Should deferred taxes be included in the rate base? Should embedded debt or the current cost of debt be the component factor? Should historical cost depreciation be used or reproduction cost? That latter is rather a nonissue because the Commission, in its calculations, has always used historical cost depreciated.

The Commission considered all of these issues on the basis of voluminous testimony from all sorts of experts, and they were upheld by the courts of appeals, and I would think that is where the matter ought to rest, but let me make this little observation about it. The argument is that while these may be highly technical matters the Commission must be wrong because they have not found any railroad to be revenue adequate.

I do not really know why anyone should be surprised at that, since we had an industry that, only 5 years ago, was on its heels, but put that aside. One would assume, then, that the new methodology proposed by CURE would result in some railroads at least being revenue adequate.

The calculations are not difficult to make. We have made them, and I would be astonished if Edison Electric has not made them. We would be glad to have our staff sit with your staff and with GAO or anybody else that you would like to have review the matter. The fact is that using the CURE methodology in all respects, no railroad in the last 5 years would be revenue adequate or even close to it except one, the Norfolk and Western, and that year would have been 1980.

It simply cannot be said that the Commission's methodology must be wrong because no railroad is found revenue adequate unless it has also said that the CURE methodology must be wrong, because no railroad would be found revenue adequate.

Let me turn lastly, I guess, to this question of numbers. The argument is, as I understand it, that the Commission is blindly prejudiced against captive shippers, and that is demonstrated by the fact that captive shippers cannot get in the door, although I gather that argument is now abandoned because the evidence clearly is that captive shippers can get in the door and win most of the cases in terms of the issue of captivity.

Their argument is, in any case, that once they get in, they cannot win, and that is proved by the fact that they never do. Now, I am not about to defend the Commission in terms of the length of time that it took them to arrive at maximum rate reasonableness guidelines for coal. I may say that this is , as a matter of observation, not a factor of the Staggers Act.

Staggers did not change the standards for maximum rate reasonableness. This effort of the Commission to determine standards has gone back at least a dozen years. They tried the so-called 7-percent solution, that is to say, fully allocated costs plus 7 percent for coal. They tried the ton-mile solution. The first one was knocked down by the courts.

I may say that if my good friend Mr. Thompson could in 3 or 4 days come up with an appropriate standard that would be upheld by the courts, I am sure the Commission would appreciate hearing it. It is not in the CURE bill, as he observed. This is not an easy question. They have finally come up with a standard that has been endorsed by some 56 of the Nation's leading economists and has already been approved by the Court of Appeals for the District of Columbia Circuit. This is the only test that has ever passed muster, but put that all aside.

The facts are these. As I get them, at least in our study, it is true that shippers have hardly won any cases. By my count, they have won three before the full Commission. It is also true that they have hardly lost any cases because they have lost only six before the full Commission in this whole period of time.

You talk about the 800-plus cases that were filed. Those were section 229 cases. I would be surprised if they should have won any of those cases, because those were cases that they had never brought until in Staggers, they were given an oportunity to challenge any existing rate and, if they did not, they would forever have to hold their peace.

Since the coal rate guidelines have been put in place, one decision has been rendered by the administrative law judge. The shipper won it. It was a coal case, so it might as well be said that the railroads never win any cases under the coal rate guildelines.

Finally, this is a new point that I would like to raise, and I am sure we are derelict in not having brought this to the attention of the Commission before. The point was brought to my attention by Chairman Dingell in the House hearings a couple of weeks ago when he asked the Commission how many cases have been brought, how many complaints have been filed about rate increases since Staggers.

I thought if all of these bad things have been going on, there must have been a deluge of complaints since Staggers, but that is not the case. We asked our members to identify for us all such cases. I am missing two of the railroads that we have inquired of, but the figures I have represent 90 percent of the industry. In the 5 years since Staggers, so far as we can tell now, only 17 complaints have been brought respecting unreasonable, allegedly unreasonable, rates.

Senator PACKWOOD. I have to ask you to conclude, Mr. Dempsey.

Mr. DEMPSEY. Let me give those figures to you for the record, because the fact of the matter is that there have been hardly any cases filed by shippers complaining of unreasonable rates since Staggers.

Thank you. I am sorry for exceeding my time, Mr. Chairman.

[The statement follows:]

STATEMENT OF WILLIAM H. DEMPSEY, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS

Mr. Chairman and members of the Subcommittee, I appreciate this opportunity to offer further comments on the so-called "C.U.R.E." bill, S. 477, which would substantially amend the Staggers Rail Act of 1980.

In my testimony last November, as well as in my written answers to questions from Senator Long, I discussed at some length the origins of the Staggers Act, its impact (which has been positive for the vast majority of both railroads and shippers), and the principal areas of controversy—the revenue adequacy standard, the market dominance standard, and the coal rate guidelines. I pointed out why the standards adopted by the Commission with respect to those matters were economically sound and submitted for the record a statement by 56 noted economists attesting to that fact. I catalogued the rate cases won and lost by shippers before the ICC since Staggers—a record that puts to rest the canard the ICC is so blindly prejudiced against shippers that they are doomed to lose. I also stated, summarily, what was wrong with the C.U.R.E. bill.[1]

Finally, I submitted with my testimony a mass of data with respect to rail coal rates. Those data show conclusively that rail coal rates since Staggers have not been "skyrocketing" and, indeed, have done little more than keep pace with inflation. As to the special cases of alleged abuse cited by C.U.R.E., I noted that the Department of Energy had examined the cases offered to it and failed to find any abuse. The ICC has now examined the cases cited by C.U.R.E. and has found the methodology employed to be fundamentally in error and the results untenable. We have examined them and found the methodology flawed, the facts distorted, and the conclusions unwarranted.

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[1] A detailed analysis of the bill and its defects are attached (Attachment 1) [The attachments are in the committee files.] By way of a general observation, the bill has no redeeming features.

I will not in this testimony revisit the legal issues I have already analyzed nor set forth again the data respecting coal rates. Rather, I will in the main focus upon the assertions of abusive railroad action leveled by different elements of the C.U.R.E. coalition, noting at the outset the limited range of shipper interests represented by that coalition.

No one who has been closely involved in the legislative and legal proceedings involving Staggers can doubt that C.U.R.E. is overwhelmingly a utility and coal industry effort. Except for the Edison Electric Institute and the National Coal Association, no other shipper organization that has actively participated in the Staggers proceedings is a C.U.R.E. member—not the largest, the National Industrial Transportation League, nor the Chemical Manufacturers Association, nor the American Paper Institute, nor the National Grain and Feed Association—all of whom have composed some or all of their differences with the AAR in the course of administrative proceedings. Indeed, the NITL has just advised the House Subcommittee on Commerce, Transportation and Tourism that:

> While [its agreements with AAR] do not solve all problems in these areas, they do make an impressive first step toward providing a reasonable framework for resolving many of them. If the agency adheres to these procedures, we believe that further legislative changes to the Act will not be necessary.

Moreover, as this Committee is aware, some 350 shippers representing a wide range of industries, organized under the acronym C.A.R.S., are actively opposing any amendment to Staggers.

Now, with this broad support for Staggers, just what is C.U.R.E.'s aim and what are its complaints? I begin with my conclusion: I do not believe any objective observer can look at the record before this Subcommittee and find a quantum of evidence remotely sufficient to justify the amendments being proposed in S. 477. There can be no mistake—the C.U.R.E. bill is nothing but a naked attempt to secure preferential rail rates for some large utilities at the expense of rail investors, other shippers, and, ultimately, this nation's interest in an economically viable transportation system.

The choice before this Subcommittee is whether it is to be guided by economic reasoning or by what, for lack of a better term, I will call C.U.R.E.'s political humbuggery. In C.U.R.E., the utilities have put together a coalition of interests each of which hopes to feast off of different plates at the regulatory table. Having failed in their economic arguments to the Interstate Commerce Commission, they hope to get to the table by political entreaty.

At the center of the table will be N.A.R.U.C.—the National Association of Regulatory Utility Commissioners. It is scarcely surprising that the state commissions have an abiding love for government regulation and a corresponding hostility toward market principles. After all, they are the ones who, in the "good old days" before Staggers, managed through delay and discriminatory rate decisions to subsidize intrastate rail traffic to the tune of $400-500 million per year—all at the expense of interstate shippers and the railroads. One can understand why the requirement for economically rational regulation which Staggers has imposed upon them is anathema.

Then we have a few rural interests.[2] Presumably, they were enticed into joining up by the abandonment and "enhancement of competition" provisions in the C.U.R.E. bill. But what evidence have they offered in support of those provisions? As to "enhancement of competition," the written comments submitted to the Subcommittee by the National Council of Farmer Cooperatives cited only one instance in support of the generally alleged abuses at the hands of the railroads and that involved an unnamed cooperative and an increased switching charge by an unnamed rail carrier. There is not a "case" as such because the unnamed cooperative apparently chose to suffer the increased switching charge in silence rather than file a complaint with the ICC. The Council explains away the absence of more particulars regarding alleged abuses of market power on the ground that its members fear economic retaliation by the railroads. In the debate to date over the Staggers Act, this is at least the most novel explanation for the inability to make one's case.

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[2] But not major organizations such as the American Farm Bureau and the National Grain and Feed Association.

The studies I have seen regarding grain rates show that, on the whole, the agricultural community is much better off under Staggers. For example, a recent study prepared for the Department of Agriculture by Kansas State University [3] states that:

Kansas local shippers did not report significant reduction in access to markets because of increases in rail switch charges or because of cancellation of joint routes . . . [S]witch charges have increased at about the same rate as increases in [inflation]. (at 35)

As to rail rates for grain, the study states:

"In the post-Staggers period, tariff rates to the Gulf of Mexico have been reduced by 34 percent . . . [T]his has resulted in an average reduction of 34 cents per bushel for a sample of local elevators." (at 35)

An analysis prepared for the Burlington Northern Railroad by the Upper Great Plains Transportation Institute, which is affiliated with North Dakota State University, found a 10.5 cents/bushel decline between 1980 and 1984 in the transportation cost of grain moving out of North Dakota. Given the volume of grain moving, this represented a transportation cost reduction of over $60 million.

A similar study by the Institute of grain rates out of Montana found that, in the period 1981-85, the rail shipment cost per bushel dropped by 17.5 cents. Because of this decline, the total cost of all grain moved out of Montana was $2,257,000 less in the crop-year 1984-85 than in the crop-year 1980-81, even though 15,760,000 more bushels of grain were moved in 1984-85. Taking into account the rate of inflation over that period, the savings to the farmer (assuming they were passed on by the shipper) were even more substantial in terms of real dollars.

A special study which the AAR conducted found that between October 1, 1980 and September 30, 1985, grain rates nationwide declined by 26 percent. I submit that these studies show quite conclusively that the agricultural community is benefitting from Staggers—and explains why agricultural support for C.U.R.E. is so thin.

The other matter of concern to some rural interests—abandonments—is also addressed by the C.U.R.E. bill, obviously as a coalition-building device. As a sop to those interests, C.U.R.E. has offered an amendment plainly designed to slow down, if not frustrate, abandonments. Here, the utilities' politics collide with their principles. The utilities have long been advocates of a general proceeding to examine the assets of all Class I railroads in order to weed out what they assert to be a vast amount of useless assets. The railroads have countered that assertion by pointing out that the abandonment process is designed to do just that, and that, for decades, the railroads have fought an uphill battle with a political process that abhors abandonments. Apparently as a matter of expediency, the utilities have now decided to come down on the side of that political process. I would hope, but not expect, that in doing so they stop alleging in other contexts that the railroads' investment base is over-valued due to managerial inefficiency.

Before leaving the subject of abandonments, I would like to call the Subcommittee's attention to another bit of testimony that has been presented to it that demonstrates quite clearly the necessity to approach our transportation problems from an economic rather than a narrow political perspective. The Georgia Municipal Association wrote to complain of the fact that the railroads had abandoned 348 miles of track in Georgia since 1977 and are proposing to abandon an additional 154 miles. It notes that some of the track being studied for abandonment is in an area of the state served by three rivers (the "Tri-River" area) and states that: "Over the past five years, barge traffic has increased greatly as a result of a major undertaking by the Corps of Engineers." It notes that the railroad segments being studied for abandonment bring traffic to the river and that traffic would be lost.

We looked up some facts about the Tri-River project and found that, in 1983, the waterway cost the federal government $5.5 million in operations and maintenance costs. For the amount of traffic moved that represented a subsidy of 7 cents/ton mile. The railroad industry's average revenue per ton-mile in 1984 was about 3 cents. That waterway, which runs to the Gulf of Mexico, duplicates the railroad system that was in place long before the Corps of Engineers decided to make it navigable. All the traffic diverted to the waterway could have moved by rail and, had it been, it is possible the line would not now be under study for abandonment—and the federal government would be saving $5.5 million per year. Federal investment in that waterway did not create competition—through a subsidy it substituted one form of transportation for another at a substantial loss to the economy as a whole.

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[3] "Impacts of Rail Deregulation on Marketing of Kansas Wheat," September, 1985.

Another member of the C.U.R.E. coalition is the American Bakers Association. Its problem is flour and it claims injury because of the Commission's failure to act against joint rate cancellations—although it fails to state how its members were injured by such actions. On the other hand, it does cite two lumber cases in which the ICC failed to order reciprocal switching, and one grain case in which the only issue was whether a switching carrier could compel a line-haul carrier to use the switching carrier's cars. The statement makes no reference to the rules adopted by the Commission as a result of the AAR-NIT League-CMA agreement procedures for handling joint rate and reciprocal switching cancellations, let alone explain why they are inadequate for dealing with the problem.

Finally, the Bakers run through the C.U.R.E. litany of remedies for captive shippers, a group which includes, by inference, numerous members of the Bakers Association. Again, no cases of ratemaking abuses of bakers are cited. It is small wonder. Data from the ICC's Waybill Sample for 1982 (the latest available) shows that the average revenue to variable cost ratio for all flour moved by rail that year was 1.15, or 115 percent of variable cost. In other words, on average, the railroads barely covered their out-of-pocket costs for moving flour. That figure is to be compared with a percentage of about 150 percent which the railroads would have to recover from all traffic to cover their fully allocated (out-of-pocket plus fixed) costs, and the figure of 180 percent which is the threshold for the Commission's regulation of the maximum reasonableness of rates. In other words, the railroad's flour traffic is extremely competitive.

We asked one of our member roads to comment on the competitiveness of flour. The answer is plain in the figures it gave us. In 1981, its revenue per ton for moving flour was $24.00. In 1985, it was up 3 cents to $24.03. Thus, in the face of a cumulative inflation rate of nearly 20 percent, revenue per ton on its flour movements rose .1 of 1 percent. Only a member of C.U.R.E. could divine an abuse of market power in those numbers.

Then, we have the American Mining Congress, another member of C.U.R.E. It weighed in with a statement in support of the nation's coal producers—its principal allegation being that the ICC has devoted itself to improving the financial condition of the railroads while ignoring the need to protect captive shippers. It, too, cited neither facts nor cases. What it really has in mind in urging the need to "protect" captive shippers is suggested, however, by one of the related concerns it expressed to the Subcommittee:

> We believe the federal government has primary concern for the ordinary operation and maintenance of the nation's waterways and therefore oppose any user fees or charges for such purposes.

Quite simply, it wants the railroad investor to subsidize its rail transport needs and the federal government to subsidize its water transport needs.

Finally, we come to the core of C.U.R.E., the electric utilities. The statement submitted to the Subcommittee by the Edison Electric Institute makes several arguments which deserve comment. First, EEI makes the point that it is the utility ratepayers who pay for the cost of rail transportation and that utilities are not allowed "to make a profit on fuel costs." This is a variation on the theme that the utilities' only concern in the Staggers fracas is for their customers. The NARUC testimony picks up the theme: "Transportation costs are not a rate base item upon which a utility earns its profit."

Both statements are literally correct. And both statements assume a high degree of naivete on the part of the reader. We are asked to believe that the utilities have poured all of the money and effort that C.U.R.E. represents into the Staggers Act controversy without expecting to gain a nickle's worth of benefit for the utility stockholder. If I were a stockholder, I would surely complain. And if I did, I expect I would get an explanation that would be somewhat different than what the utilities have been asserting to the Congress.

For those familiar with the regulatory environment, the situation, I suggest, is clear. As a practical matter, the lower the utilities can hold their operating costs, the better chance they have of increasing their profits (i.e., their cost of capital). Given the politically charged environment in which they operate, regulatory commissions are more likely to grant a rate increase of, say 5 percent than one of 10 percent, even though the return on capital—"profit"—may be larger for the first than the second.

If any proof were needed for what I think is this self-evident proposition, that proof is afforded by the comparative data on utility rates, profits, and costs since Staggers. The conclusion that I reach—and that I ask you to consider—is that the utilities, through C.U.R.E., have had a good thing going and want to continue it—low energy costs, including transportation, and correspondingly higher profits.

The AAR study on electric utility rates and profits which I submitted with my testimony of November 1 shows what has happened generally in the last 5 years to fuel costs and capital costs (profits) in the utility industry. Succinctly stated, between 1981 and 1984 fuel costs increased $842 million while total revenues increased $24.4 billion. Of the latter amount, more than $7 billion went to utility investors. These figures suggest to me that the utilities care a lot more about their profits than they do their consumers. The figures also present a classic case of someone who is willing to tighten someone else's belt but not its own.

The cost data for the members of C.U.R.E that we have examined conforms to this general picture. Thus, Central Louisiana Electric Company's revenues increased by $50 million between 1982-84. One million dollars of that amount went to pay for an increase in the delivered price of coal, while $17 million went to an increase in net income.

Or, take the Illinois Power Company. From 1980 to 1984, its revenue increased $243 million, rising from $567 million to $810 million. During the same period, the delivered cost of fuel (99.3 percent of which was coal) rose by $13 million (an increase of 5 percent). Its net income, on the other hand, rose by $122 million (an increase of 107 percent). In 1984, for every additional dollar paid for fuel, the company made an additional 9 dollars in net income.

Then we have Kansas City Power and Light. The Subcommittee may recall that three years ago the chairman of its Board, Arthur J. Doyle, testified on behalf of the Company and the Edison Electric Institute about the outrages being perpetrated under Staggers.

Mr. Doyle's company recently asked for a 64 percent rate increase spread over four years to pay for its Wolf Creek nuclear power plant or, in the alternative, a one-shot increase of 52 percent. It was granted only a 14.7 increase (ans is seeking a rehearing). In the 5 year period 1980–1984, its coal costs increased about 35 percent. During the same period, its net income increased 124 percent.

Finally, we have the Potomac Electric Power Company. Its President, Edward Mitchell, rarely fails to note in his testimony that Pepco's coal rates increased approximately 80 percent in the 6 year period 1979–1984. I have not verified that figure but I would note that the railroad's inflation rate during the same period increased 68 percent. So assuming Mr. Mitchell's figure is correct, the real growth in rail coal rates to Pepco's plants has averaged only about 2 percent per year. But let's look at Pepco's earnings:

For the period 1980–84, Pepco's earnings increased from $88.8 million in 1980 to $152.3 million in 1984. Earnings per share went from $2.10 to $3.23.

Pepco's annual dividends increased from $61.8 million in 1980 to $91.5 million in 1984. Accumulated retained earnings in that period increased from $206.3 million to $358.8 million.

The average return on equity in the electric utility industry in 1980 was 11.4 percent. So, with a 12.2 percent return, Pepco was a very profitable company. But, being very profitable did not dissuade Pepco from seeking to impose higher rates on its "captive" customers:

In 1980, Pepco asked for a $98.2 million rate increase and was granted $54 million;

In 1981, it asked for $37.1 million and was granted $35.4 million;

In 1982, it asked for $187.2 million as was granted $67.8 million;

In 1983, it asked for $85.6 million and was granted $25.6 million;

In 1984, it asked for $80.1 million and was granted $29.9 million. At that point, its return on equity stood at 16.6 percent.

As part of the last rate hike, Pepco was told not to come back for more before 1986 so, notwithstanding a very high profit level, another rate increase may surface shortly.

Now let's look at what was happening to Pepco's fuel costs over this period. The cost of fuel (90 percent of which is coal) was $2.17 per kilowatt hour sold in 1980, $2.08 in 1981, $2.42 in 1982, $2.24 in 1983, and $2.06 in 1984. It would seem that the cost of capital (profits) were driving up Pepco's costs much faster than the cost of coal (including rail coal rates).

So much for the notion that the utilities' motive in proposing the C.U.R.E. bill is to help their customers and not their stockholders.

Next, EEI trots out its tattered and battered study on coal profitability to show how much money the railroads are really making off of them. The ICC's Bureau of Accounts submitted its comments on the EEI study to the Subcommittee last November and pointed out that it contained methodological flaws which would yield erroneous results. Subsequently, it received EEI's underlying work papers which had previously been withheld and has issued an updated evaluation of the coal profitability study. The Bureau examines the specific claims made in the study, all of which are repeated in E.E.I.'s testimony:

"1. On a ton-mile basis, the cost of moving coal is the lowest of all commodities.

2. After adjustment, coal's ton-mile costs are approximately 43 percent of the average cost of all other commodities combined.

3. After adjustment, the revenue to variable cost ratio for coal is 180 percent, this is the highest of all major commodities.

4. Coal generates a margin of profit over cost of 44 percent, the highest of all commodities."

As to the first point, the Bureau's evaluation states that:

EEI appears correct in stating that the cost per ton-mile for transporting coal is the lowest of all commodities. It is also interesting to note that coal has the lowest revenue per ton-mile of all major commodities. Subtracting attributable cost from revenue gives a revenue contribution to unattributable cost and profit per ton-mile which ranks [coal] approximately eighth out of the sixteen commodities listed. This measure of revenue contribution cannot be used to show excessive profits. (at 15)

The Bureau of Accounts then evaluates the process on which the next three claims rest and concludes that:

Given the questionable adjustments made to reduce costs both the profitability and the revenue to variable cost ratio of coal is subject to question. As shown above, coal's profitability as measured by contribution over variable cost is not the highest but about the average of all commodities. (at 17)

So much for E.E.I.'s study as to the profitability of coal.

After a lengthy discussion of how ICC's implementation of Staggers has resulted in inequitable treatment of captive shippers—a matter to which I shall return—the EEI next examines ICC policies that "have allowed the railroads to charge excessive rates." It asserts that the railroads' use of average rate data to show the absence of rate abuses is misleading for two reasons:

First, using a general average of all rate increases fails to reflect major increases on individual movements. Second, the railroads and their supporters ignore the fact that for a significant number of coal burning utilities, the most significant harm flowing from ICC policies under the Staggers Act is found in the protection and perpetuation of pre-Staggers Act rate actions, rather than the encouragement of post-1980 abuses. The railroads and the ICC claim to have looked for abuse and found none. In truth, they have been deliberately looking in the wrong place. A more meaningful period of time for viewing the extent to which rail rates have increased is the period since passage of the 4-R Act in 1976. (emphasis supplied)

I find this statement absolutely astonishing. For at least three years the utilities have been raising a hue and cry over railroad ratemaking abuses under Staggers. Now, we are suddenly told that the ratemaking abuses complained of were not occasioned by Staggers but occurred *before* Staggers, and that the real harm suffered by the utilities is not due to the ICC's encouragement of post-Staggers abuses but in its "protection and perpetuation of pre-Staggers Act rate actions." And worse, we are accused of "deliberately looking in the wrong place" for the truth of the matter.

If any further evidence were needed of the bankrupt position of the utilities in the entire Staggers Act regulation issue, this is it. They have been trumpeting for years about skyrocketing rail rates. We have responded with conclusive evidence that on average neither coal rates, nor any other rates, have risen significantly faster than the inflation rate. Having their feet swept out from under them on that charge, the utilities shifted their ground and claimed that averages don't reflect individual abuses—and they then proceeded to identify specific allegations of abuse. They sent eight of them to the Department of Energy which, because of the coal and utility interests general claims of abuse, had decided to undertake a study of rail coal rates. After the DOE staff had studied these cases, it issued a draft report in which it cited the eight cases and stated that it "* * * found no evidence that railroads have imposed 'abusive' rates on coal since 1980. * * *"

Armed with the results of his staff's study of EEI's "worst cases", the Secretary of Energy wrote the Presidents of EEI and the National Coal Association, stating:

I know that there is an effort to try to cause Congress to do away with parts or all of the Staggers Act and restore ICC regulation to railroad coal rates. It would seem that unless someone can come up with some better evidence to support the case, we are not on the right track. That means that if you succeed, we cannot expect to solve the real problems of coal competitiveness by such a law change and we will have wasted time that could have been spent seeking real solutions.

The EEI was undaunted. It drummed up eleven more "worst cases", added them to the eight that had already been discredited, and started peddling their 19 cases of railroad abuse. Our analysis of those 19 cases is attached (Attachment 2). The most charitable thing I can say about them is that they are marked by gross error, misleading statements, and unsupportable manipulations of data.

But I may be prejudiced, so let's look at what the ICC's Bureau of Accounts has to say about them:

> Based on the support documentation EEI provided the ICC, it appears that the return on investment computations are in fact based on a series of unsubstantiated imputations and postulations. With the possible exception of revenue, all data for the study are based on previously disputed and rejected estimates or derived by means of "back of the envelope" computations. Finally, the various numbers are strung together by a series of tenuous assumptions to arrive at the return on investment reported in the July 1985 study.
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> Based on BOA's evaluation of EEI's methodology, it is clear that no conclusion can be drawn on the profitability of the 19 coal movements identified by EEI. Relying primarily on revenue to variable cost ratios, EEI has piled assumption upon assumption and generalization upon generalization to achieve its results. Movement specific expenses, investment, demand, operating conditions have all been ignored as has the broadly recognized need for differential pricing. Given the information and methodology employed by EEI, it is not possible to compute the earnings of any individual railroad movement.

Having failed to show that rail rates generally have escalated under Staggers, and their 19 cases having been revealed to be baseless, the utilities are apparently reduced to the argument that they have been deliberately misunderstood. As now stated, EEI's case boils down to this—because of a handful of complaints pending at the ICC based on rail rate action taken in years preceding Staggers, the Congress should now reimpose on the railroads all of the regulatory trappings set forth in S. 477. I maintain it is time to call a halt to this farce.

Perhaps the Commission has not acted with as much alacrity as it might, but look at some of the extenuating circumstances. Because the opportunity section 229 of Staggers gave shippers to file complaints against any rates in effect October 1, 1980, the Commission received 864 complaints (most on the 180th day allowed for filing). Over the last five years, the ICC has been operating with a steadily reducing number of personnel. And, perhaps of most importance, the issues before it have not been easy ones.

The utilities now rail against the Commission because it took seven years to issue the coal rate guidelines. But the Commission was not sitting on its hands for seven years. It tried to implement two standards—the "7 percent solution" and the "ton/ton mile" formula—which could not pass judicial scrutiny because they were inherently arbitrary. It is that process which brought the Commission to the stand-alone cost concept—a concept that has survived judicial scrutiny because it is economically rational.[4]

But for all their complaints about the delays in the coal rate guidelines proceeding, what do the utilities propose? More proceedings. They have had seven years to think about coal rate guidelines and the best they can do is ask the Congress to tell the ICC to go back to the drawing board and come up with anything but stand-alone costs. And so in the C.U.R.E. bill the Congress would say to the ICC, the courts have turned you down on any standard except stand-alone costs, and we turn you down on that. See what else you can do. To put it as conservatively as I can, I suggest that would be irresponsible.

I do not deny for a moment that the implementation of Staggers has been difficult for some shippers. It has been difficult for some railroads. Railroads have been attacked for cancelling joint rates. I know that railroad officers are convinced that they took the only course possible to rationalize their rate structures and realize their marketing objectives. But leaving aside the merits of particular actions, the general problem has been addressed. We met with the concerned shipper groups and developed a compromise which I believe is workable.

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[4] *Potomac Electric Power Company et al.* v. *Interstate Commerce Commission et al.*, 744 F.2d 185 (1984). E.E.I. also devotes about 10 pages of testimony to the alleged difficulty of complying with the coal rate guidelines. Our comment on that aspect of its testimony is attached (Attachment 3). In assessing this complexity argument, the reader should keep in mind the fact that the stakes in the typical coal rate guideline case are reckoned in the millions of dollars per year.

The same thing happened with the market dominance guidelines. We believed then, and believe now, that the guidelines adopted by the Commission were economically sound. Some shippers, however, had legitimate concerns and we worked out another compromise—one which gives the shippers most of the relief they wanted without seriously undermining the economic principles involved.

With Staggers, the Congress created the framework necessary for economically rational regulation of the railroad industry. I sincerely believe that the Commission has tried to carry out the Act in its true spirit. And, I sincerely believe that if any group of shippers comes to the bargaining table with grievances that can be resolved without sacrificing the basic economic rationale on which the current regulations are premised, acceptable compromises can be reached with the railroad industry. And, based on experience to date, the Commission stands ready to accept those compromises.

But the utilities have refused to come to the bargaining table. That refusal may well stem from the fact that they are not prepared to negotiate from an economically rational base. If a regulatory regime designed to subsidize coal is their objective—and that is certainly apparent in S. 477—there is no basis for negotiation.

On the other hand, if they have an economically rational alternative to stand-alone cost as a ratemaking standard, for example, we will be happy to sit down with them. If they have economically rational alternatives to the status quo on any regulatory issue, the door to the negotiating table is open. But we will not abandon, and we will fight as long and as hard as we can to persuade this Subcommittee and the Congress that it should not abandon the economic premises upon which Staggers now rests.

There is no free lunch. If this nation wants rail service it has to pay for it. The Congress could, in its power, take the cost burden off of one group of shippers and place it on another group, or place it on the rail investors. But, in either case, the ultimate result would be the same—the atrophy and eventual demise of the rail system.

COMMENTS ON OTHER LEGISLATIVE PROPOSALS

The DeConcini Bill (S. 447). Your letter of February 11 inviting me to testify asked for my views on legislation proposed to amend the Staggers Act. S. 447 is a bill pending before the Judiciary Committee and purports to amend the Sherman Act, not the Staggers Act. I call the bill to your attention because it is in fact a proposal to regulate rail rates through the courts rather than the Commission and directly conflicts with Staggers.

The bill presumes that any railroad which owns the only rail facility servicing all or any part of a movement of "bulk commodities" (defined to include even perishable commodities moving in piggy-back service) is an unlawful monopoly. To purge itself of this monopoly, a railroad is given two choices. It can allow another carrier to use its tracks (under an ill-defined compensation standard) or it can lower its rate on the traffic involved on a proportion-of-full cost basis (i.e., eliminating differential pricing). Any dispute as to compensation or rates would be resolved by the courts. Consequently, rates that are entirely lawful under Staggers could be entirely unlawful under S. 447.

S. 447 is so bad that to describe it is to condemn it. It is my understanding that the bill's sponsors are considering revisions to it, presumably in an effort to cure its most obviously objectionable features. I call it to your attention because it is a back-door attempt to amend Staggers. Should it emerge from the Judiciary Committee, I would urge you to seek referral prior to its consideration by the full Senate.

The C.U.R.E. bill has its own trackage rights provision, albeit a more modest one. It would compel (rather than permit) the Commission to grant trackage rights for a reasonable distance outside a terminal where necessary to provide alternative competitive rail service. Thus, the area could be awash with truck competition and a railroad could still be compelled to allow another railroad to use its track. The compensation to the owning carrier for the forced use would be any costs incurred as a result of the use and an allocated share of the fixed costs of the facilities actually being used by the other carrier.

The utilities' proposed policy regarding compulsory trackage rights for railroads and the appropriate compensation standard is completely at odds—as in so many other instances—with the policies they advocate for themselves. Thus, the spring 1985 edition of the E.E.I. publication "Electric Perspectives" included an article dealing with the problem of "wheeling" power—the equivalent of trackage rights in that one utility is forced to transmit over its lines power purchased by one of its customers from another utility.[5] The authors maintained among other things that:

"Without the stability of exclusive service areas and reasonable protection against 'pirating' of existing customers, there would be uncontrolled customer 'rate shopping' to take advantage of * * * short-term rate differentials."

"Adverse rate impacts would result if large shippers were allowed to shop around and purchase power off-system."

Fixed costs would have to be borne by the remaining customers who "* * * would be required to pay inordinately higher rates for service in what could be a continuous upward spiral."

"Without a defined and reasonably predictable geographic market for the output of its power—or a substantially higher rate of return on investment—no electric supplier would continue to incur the considerable financial risk of building new generating facilities * * *" (at 8 and 9, underscoring supplied)

All of these considerations are, of course, equally applicable to the railroads. Why would a railroad continue to invest in new plant if it knew it would have to share that plant with a competitor for inadequate compensation? The utility spokesmen note that in such a situation "a substantially higher rate of return on investment" would be required. The C.U.R.E. bill, on the other hand, would grant a railroad no more than an "allocable share" of the cost of the facility being used.

Here, as elsewhere, C.U.R.E. demonstrates a total lack of concern for consistency in the application of principles.

The Proposed Symm's Amendments. You have asked me to comment on two amendments to the contract section of Staggers which are being proposed by Senator Symms. The first would amend section 10713(d)(2)(B) of Title 49 U.S. Code to require all rail contracts involving grain be made available to the public. Such a requirement would, in my judgment, impair the usefulness of agricultural contracts.

As you know, the AAR and the National Grain and Feed Association have negotiated an agreement which would improve the public summary of contracts filed with the ICC, promote voluntary disclosure of contract information to affected shippers, and improve and facilitate the discovery process where voluntary measures were insufficient. That agreement has been filed with the ICC and I am hopeful it will receive favorable consideration in a pending rulemaking proceeding.

It was evident in the negotiations with the NGFA that the agricultural community is rather deeply divided on the issue of public disclosure. All of the evidence proves to me that the farmer is best served by the availability of the contracting authority and that, without confidentiality, that authority would be seriously impaired.

Senator Symms' second amendment appears to be an attempt to set the price for the use of shipper-owned equipment whenever a railroad enters into an agricultural contract involving the use of shipper-owned equipment. All of the terms of rail-shipper contracts should be negotiable. Attempts to dictate terms legislatively can only discourage the use of contracts. The private hopper car compensation issue is now in litigation before the Commission. The outcome of that litigation will determine the compensation standard applicable to tariff moves. If a railroad and its shipper choose to contract rather than utilize the prevailing tariff, they should not be inhibited by arbitrary legislative limitations.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR HOLLINGS AND THE ANSWERS

Question 1. CURE has included in its testimony what it considers examples of rate abuse with no recourse at the ICC. What is your response to these specific cases?

Answer. The examples provided by CURE beginning at page 11 of Mr. Thompson's testimony are the same as those CURE presented to the Subcommittee in November. I provided a response in my letter of December 19, 1985 to Chairman Packwood.[1] (See pages 10-17.) I am attaching a copy of that letter.

At various times CURE and the Edison Electric Institute have provided other examples of so-called "rate abuse." These examples have been researched and discredited by the Department of Energy and the Interstate Commerce Commission. I am attaching,[2] for your reference, copies of the AAR's responses to these additional examples of "rate abuse."

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[5] "Mandatory Wheeling: Is Competition in the Nation's Best Interest?" Douglas C. Bauer and Bruce S. Edelston.

[1] See S. Hrg. 99-502, p. 391.

Question 2. CURE has testified that in assessing whether coal rates have increased since passage of the Staggers Act, one should look at specific cases rather than industry averages. What is your response to these comments?

Answer. I think the Subcommittee should consider both industry averages and individual cases. When you do that, I believe you will be compelled to find that not only are there no instances in which railroads have abused captive coal shippers but that most coal shippers have benefitted from every moderate rates since passage of the Staggers Act.

Looking first at industry averages, during the first two years after enactment of the Staggers Act coal rate increases exceeded inflation by very modest amounts—2.3 percent in 1981 and 3.4 percent in 1982. Since that time, railroad coal rates have increased less than inflation, that is, they have *declined* in real dollars. During this time, railroads and coal shippers have entered into voluntary contracts that now govern the movement of 62 percent of all rail-hauled coal, including 86 percent of all coal moved for export. I would suggest that this record hardly makes a case for alarm.

Turning to individual cases, as I indicated in my response to Question 1, not a shred of evidence has been produced that can stand up to impartial review to indicate that railroads are abusing captive coal shippers, or any captive shippers for that matter. There is certainly nothing on the record presented to this point by CURE, the Edison Electric Institute and other advocates of reregulation. There is a point to remember with respect to any instances of captive shipper abuse that do occur. The Staggers Act specifically addresses this issue and provides that a shipper can obtain relief—including reparations—should a railroad charge unreasonable rates.

Question 3. S. 477 would shift the burden of proof in rate reasonableness cases from the shippers to the railroad. How do you view this provision? What do you think would be its impact?

Answer. I addressed the provision of S. 477 to which you refer in the critique of the legislation that I provided in Attachment 1 [3] to my testimony of February 21, 1986. (See pages 6 to 9.) I am attaching a copy of that critique. Briefly, the law presently provides that the railroad bears the burden of proof if a shipper protests a rate increase before it takes effect and the ICC, based on the grounds set forth in the protest and the requisite jurisdictional finding, decides to suspend and/or investigate the rate. If the shipper initially does not convince the ICC to suspend and/or investigate the rate, it is entitled to a second bite at the apple through filing a complaint after the rate takes effect. Only in taking this second bite does the shipper assume the burden of proof.

The proposal in S. 477 that the railroad bear the burden of proof in *every* instance would permit a shipper to put the railroad through the regulatory wringer twice simply by filing two pieces of paper—complaints before and after the rate takes effect. The railroad would bear the full cost of making a case in both proceedings. In my view, this shift in the burden of proof in complaint cases is intended—and would be used—as a litigation club to deter or temper railroad rate increases, whether or not such increases are justified.

Question 4. Much concern has been raised about the ICC's coal rate guidelines and in particular the stand-alone cost standard. How would you envision these guidelines being applied? How would you expect proof of stand-alone costs to be presented?

Answer. I provided a detailed response to the concerns raised by the Edison Electric Institute concerning the ICC's coal rate guidelines in attachment 3 [4] to my testimony of February 21, 1986. The gist of my response is that the coal rate guidelines, including the stand-alone cost provision, has not added significantly (if at all) to the amount or complexity of evidence required in ICC rate proceedings—it has simply changed the nature of the evidence. I am including a copy of that attachment.

Under the guidelines, a shipper may present evidence concerning:

(1) The extent to which a railroad is revenue adequate. Under the guidelines, if a railroad is revenue adequate it may not raise rates to captive shippers beyond simply keeping pace with inflation. However, the ICC stated explicitly in the guidelines that it will not hesitate to reduce the rate of a revenue inadequate carrier if the rate is unreasonable.

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[2] The attachment was retained in the Committee files.

[3] Ibid.

[4] Ibid.

(2) Whether the railroad is engaging in inefficient management and pricing practices (the Long-Cannon factors).

(3) The stand-alone cost of the movement in question. Some advocates of S. 477 grossly mischaracterize the stand-alone cost of a movement as "the cost for a shipper to build its own railroad." In fact, the stand-alone cost of a movement is the *minimum rate* a hypothetical competitor, designed at the sole discretion of the shipper using any transportation mode it desires and serving only the customers it wishes, would have to charge to earn an adequate return on its investment. Put another way, a coal shipper is free to hypothesize construction of a coal slurry pipeline serving any points it specifies, and the railroad rate cannot exceed the minimum rate that pipeline would have to charge to earn an adequate return. The ICC's stand-alone cost concept provides the shipper with the best of all worlds—the benefit of a competitive rate from a custom-designed competitor without the risk and expense of actually constructing the competing system.

(4) Evidence that the impact of the proposed rate increase should be mitigated through a phase-in requirement.

In January, an ICC administrative law judge handed down the first decision using the guidelines (No. 38783, *Omaha Public Power District* v. *Burlington Northern Railroad Company*, not printed, decided January 10, 1986.) That case was decided for the shipper. Although the AAR does not necessarily agree with the way in which the judge applied the guidelines, the case does illustrate that a shipper can present a successful rate case using them.

Question 5. S. 477 would direct changes in the way the ICC computes revenue adequacy. What will be the practical impact of these changes on rail rates?

Answer. CURE seeks legislative changes that would open the door to subjective factors in the ICC's revenue adequacy deliberations. A subjective approach to this issue in the pre-Staggers era found 13 railroads were revenue adequate despite the fact that some were earning rates of return on investment as low as 4 percent! If the changes CURE seeks are enacted and we revisit that era, the practical impact on rates will be that some carriers with very low rates of return will, for all practical purposes, have their rates capped. The practical impact of that, of course, will be that investment will flow out of the railroad industry and we will revisit the era of deteriorating track and service, railroad bankruptcies, and threatened nationalization that led to enactment of the Staggers Act in the first place.

Questions of Senator Symms and the Answers

Question 1. In the past five years, since enactment of the Staggers Act of 1980, in how many instances has the Interstate Commerce Commission found that a complaining shipper has been the subject of unreasonable discrimination?

Answer. In enacting the Staggers Act of 1980, Congress considerably narrowed the scope of the unreasonable discrimination provisions of the Interstate Commerce Act, 49 U.S.C. 10741, by exempting, *inter alia*, contract rates, surcharges, separate rates for distinct rail service and rates applicable to different routes from the discrimination section of the Act. Correspondingly, the provision of the Staggers Act allowing rate and service contracts between carriers and purchasers of rail service, 49 U.S.C. 10713, established a limited discrimination remedy applicable only to ports and agricultural shippers. With respect to a contract for the transportation of agricultural commodities (including forest products and paper), the contract section provides that a complaint may be filed by an injured agricultural shipper where "the rail carrier has unreasonably discriminated by refusing to enter into a contract with such shipper . . . for the transportation of the same type of commodity under similar conditions to the contract at issue, and that shipper was ready, willing and able to enter into such a contract at a time essentially contemporaneous with the period during which the contract at issue was offered. . . ." 49 U.S.C. 10713(d)(2)(B)(i). Should the Commission find a violation of this provision, the agency is empowered only to order the carrier to provide rates and service to the complaining shipper "substantially similar to the contract at issue. . . ." 49 U.S.C. 10713(d)(3)(B).

The Association of American Railroads (AAR) does not keep records regarding the number of disposition of unreasonable discrimination claims filed with the Interstate Commerce Commission. Based on information provided to the AAR by the Interstate Commission, there appear to be four cases in the past five years where the Commission has found that a complaining shipper has been the subject of unreasonable discrimination under section 49 U.S.C. 10741. (The AAR has not independently verified the accuracy of the information provided by the Commission.) As described by the Commission these cases are:

1. Docket No. 37629, *Saramy* v. *Burlington Northern* (decided 7/14/82) (discrimination found in car allocation).

1. Docket No. 37610, *General States Grain & Trading Co.* v. *Norfolk & Western* (decided 8/18/81) (discrimination found in rates).

3. I&S No. 9224—*Increased Rates on Scrap Iron & Steel, Ex Parte 319S* (decided 4/16/871) (pre-Staggers Act case; discrimination found in recyclable rates).

4. Docket No. 37146, *Transit on Wheat Between Reshipping Points & Destination* (decided 8/13/82) (pre-Staggers Act case; rate discrimination found).

As regards contract rates, additional information provided by the Commission indicates that there have been 13 requests by shippers for contract disclosure in the last five years (of which eight were granted and five were denied by the Commission), but that no unreasonable discrimination claims have been brought by shippers under the contracts provision of the Act. (Again, the AAR has not independently verified the accuracy of the information provided by the Commission.)

Question 2. How soon after the filing of a contract must a shipper, believing itself the subject of unreasonable discrimination, petition the I.C.C. for disclosure of the contract's terms or be forever barred from learning its contents?

Answer. Under the contracts provision of the Interstate Commerce Act, 49 U.S.C. 10713(d)(1), the Commission has 30 days after the filing of a contract to begin a proceeding, on its own initiative or on complaint, to review such contract. To accommodate the 30-day statutory time frame for the commencement of Commission action based upon shipper complaint, the Interstate Commerce Commission's contract disclosure rules provide that a shipper must file a request for contract disclosure within 18 days of the filing of the contract (and nonconfidential contract summary) with the Commission. See interim discovery rule § 1300.310(b)(3) (adopted July 13, 1984).

The National Grain and Feed Association (NGFA) and the Association of American Railroads (AAR), by a joint petition filed with the Commission on November 14, 1985, have proposed certain modifications to the Commission's current disclosure rules with respect to contracts for the transportation of raw grains and soybeans—one of which would allow for voluntary disclosure of such contracts by a rail carrier without the necessity of initial shipper resort to the Commission. (Only in the event that the carrier objected to voluntary disclosure would a disclosure request be filed with the Commission.) The NGFA/AAR proposals are currently under consideration by the Commission in a pending rulemaking proceeding. (Ex Parte No. 387, *Railroad Transportation Contracts* (record reopened April 2, 1986 to consider NGFA/AAR proposals)).

Question 3. How will such a shipper even have knowledge of the contract's filing within this short period of time?

Answer. There are various commercial contract watching services available to shippers which serve the function of promptly alerting subscribing shippers to rail transportation contract filings that may be of interest to them (e.g., Watching Service, Traffic Service Corp., 1325 G St., Washington, D.C. 20005). In addition, at least one weekly transportation magazine (*Traffic World*) subscribed to by shippers, transportation consultants and other parties interested in transportation matters publishes each week a complete list of rail contract summaries filed with the Commission.

Further, all contract summaries filed with the Commission at its Washington, D.C. office are matters of public record, and shippers or their agents may obtain information or advice regarding contract filings directly from the Commission.

Question 4. Isn't the most effective mechanism for avoiding unreasonable discrimination the posting and publication of rates?

Answer. Not necessarily. The contracts provision of the Staggers Act, and the implementing regulations of the Commission, provide a comparable mechanism for avoiding unreasonable discrimination in rail transportation contracts while also providing the parties with important additional benefits of negotiated agreements that can only be preserved by protecting contract terms from unnecessary public disclosure.

The Staggers Act statutory scheme is intended to alert agricultural shippers (and ports) to contracts that have the potential to unreasonably discriminate against them by requiring that carriers file all contracts with the Commission along with non-confidential summaries of contract terms. 49 U.S.C. 10713(b). The non-confidential contract summary (as pertains to a shipment of agricultural goods) contains such information as: names of participating carriers, commodity or commodities to be transported; origin stations and destinations; duration of the contract; number of dedicated cars; base rate and charges; movement type (e.g. single car, multiple car, unit train); minimum annual volume; summary of escalation provisions; and identification of existence of special features (e.g. transit time commitments, credit terms, etc.). 49 C.F.R. § 1312.41(d). Based on the non-confidential contract summary, a potentially affected shipper is given sufficient contract information to ascertain those contracts which may warrant further scrutiny through specific disclosure requests filed with the Commission seeking more specific contract information.

The Staggers Act contract disclosure scheme, however, while preserving the ability of affected parties to obtain disclosure of contract terms which may be potentially discriminatory, also serves the important purpose of keeping such contract terms confidential to the maximum possible extent in the interest of fostering service efficiency and competition in the provision of rail services. Just as with any other private business arrangement, unwarranted public disclosure of the terms of negotiated rail transportation contracts can only serve to reduce the parties' negotiating flexibility in offering rate and service concessions because, if the terms were made public, non-contracting parties—whether shippers or other carriers—would demand the same concessions regardless of their differing competitive circumstances. Carriers, for example, would be less willing to tailor their rates and services to particular shippers' needs if they knew that any concessions made would likely form the minimum basis of other shippers' contract demands. Moreover, public disclosure of railroad transportation contracts to other carriers would also have the effect of fostering the standardization of prices offered by railroads for their services which would inhibit intramodal rail competition. "[I]t has long been recognized under the antitrust laws that public disclosure of contract terms can undermine competition by stabilizing prices at an artificially high level . . ." *Water Transport Ass'n* v. *I.C.C.*, 722 F.2d 1025, 1032 (2d Cir. 1983) (upholding the Commission's contract rules prohibiting public disclosure of specific contract terms.)

The Staggers Act contract confidentiality provisions provide important rate and service benefits to shippers, carriers, and the public, while also allowing affected shippers to fully protect themselves against unreasonable discrimination through specific disclosure requests. The benefits of the statutory scheme underlying rate and service contracts would only be jeopardized—with little or no advantage to the shipping community—by requiring the posting and publication of contract rates.

Question 5. Haven't the Canadian National and Canadian Pacific, which had the right to negotiate contract rates long before United States railroads did, been obliged to post and publish their contract rates?

Answer. Since passage of the National Transportation Act of 1967, the Canadian National and Canadian Pacific Railroads have had the right to negotiate contract rates which shippers subject to the requirement that all such contract rates be published and filed with the Canadian Transport Commission. Recently, however, the Canadian Minister of Transport undertook a comprehensive study of current Canadian transportation law, including laws governing the transportation of freight by rail, and in a published July, 1985 report (*Freedom to Move—a Framework for Transportation Reform*) concluded that changes in such laws were warranted to further promote domestic and international competition in the provision of rail freight services. One of the principal changes recommended by the study was that Canadian railroads be permitted to enter into confidential contract rate agreements comparable to their U.S. counterparts in order to spur intramodal rail competition and provide rail carriers and shippers with additional flexibility to negotiate rate and service agreements tailored to their specific needs.

In a subsequent report by the Standing Committee on Transport to the Canadian House of Commons (Sixth Report, December, 18, 1985), the Standing Committee endorsed the conclusions of the Minister of Transport and recommended that Canadian rail carriers be permitted to enter into confidential contracts for both the transborder and domestic movement of goods. It is our understanding that legislation is currently being drafted in the Canadian Parliament to achieve this objective as well as other deregulatory reforms in Canadian transportation law recommended by the Standing Committee.

BOXCARS

Before responding to the specific questions, the AAR would like to address the general scope of the amendment. (The amendment is described as one bearing on rates associated with the use of shipper-owned boxcars. The language of the amendment, however, is not restricted to boxcars.)

The amendment would require the railroads to reduce rates or pay allowances to reflect shippers' car costs whenever the railroads enter into a contract for the transportation of agricultural commodities (including forest products and paper) in shipper-owned or leased cars. The amendment constitutes an unwarranted intrusion into the freedom accorded railroads and shippers to enter into contracts. It mandates that a certain element (i.e., shipper car costs) must be reimbursed by the using railroad. But such a condition may eliminate the economic incentive of a railroad to enter into a contract. The amendment requires that a railroad reduce rates or pay allowances to reflect shippers' car costs even when the economics of a situation may not justify such a requirement. When more cars are available in a particular location or for particular traffic than are needed, the value of each of those cars to the railroad will likely be far less than the shippers' costs associated with ownership of the car. Freight rates and allowances should reflect the economic value of private cars in the marketplace and should not be held rigidly to some underfined concept of a "shipper's expenses of owning such equipment." If a shipper makes a business decision to invest in his own rail cars, that shipper also assumes the risks of such an investment. No justifications exists for the imposition of the costs associated with that business decision on the railroads.

Question 1. Do the railroads perceive of themselves as common carriers in performance transportation under contracts negotiated pursuant to section 208 of the Staggers Rail Act of 1980, 49 U.S.C. §10713?

Answer. It is generally understood that railroads performing transportation under section 10713 contracts do not do so as common carriers. The transportation is performed pursuant to the terms of the contract and under the provisions of section 10713 "[a] party to a contact . . . shall have no duty in connection with services provided under such contract other than those duties specified by the terms of the contract." 49 U.S.C. 10713(H). A contract may include provisions which resemble requirements imposed on common carriers, but that is only so because the parties have agreed to those provisions in the contract.

Question 2. Do the railroads perceive of themselves as common carriers in performing transportation that has been exempted by the Interstate Commerce Commission pursuant to section 213 of the Staggers Rail Act of 1980, 49 U.S.C. §10505?

Answer. Transportation performed pursuant to a §10505 exemption is, by definition, exempt from, and not performed pursuant to, the provisions of the Interstate Commerce Act. It is the Interstate Commerce Act which imposes common carriers obligations on the railroads (49 U.S.C. §11101), so an exemption from those obligations would render a railroad something other than a common carrier as to the transportation service performed pursuant to the exemption. (Where a partial exemption has been granted, however, a review of the specific Commission exemption involved is required. For example, railroads are legally obligated to supply and interchange boxcars even though boxcar traffic is generlly exempt.) In providing transportation pursuant to an exemption, a railroad may choose to do so through publication of a circular or other notice or by contract. While such a contract may contain various obligations typical of common carrier service, an exemption eliminates the common carrier obligations of the Interstate Commerce Act. Of course, if the Interstate Commerce Commission grants an exemption, it does not lose jurisdiction over the subject matter. Upon petition by an interested party, the Commission may act to revoke such an exemption in whole or in part.

Question 3. Insofar as the railroads are not common carriers however, have they any obligation to provide shippers with cars for loading their freight?

Answer. In those circumstances where a railroad conducts a transportation service to contract or under an exemption, the railroad is under no common carrier obligation to provide railroad-owned cars.

In such circumstances, whether railroad-owned cars or shipped-owned cars will be used for a particular service depends upon the railroads' offer to provide service and the existence of any agreement for the provision of cars that may be concluded between a particular shipper and a railroad.

Question 4. Would the answer be different if the question as to the railroad's common carrier obligation pertained to specialized cars, as, for example, all-door cars uniquely suited for the loading of finished lumber?

Answer. No. Even when they provide service as common carriers, the railroads are not generally obligated to supply "specialized" cars unless they hold themselves out to provide such equipment. (For example, the railroads generally do not hold themselves out to provide tank cars. As a result, virtually all rail service involving tank cars is performed with privately-owned cars.) A shipper's preference for a particular type of "specialized" car may simply be a matter of convenience to that shipper. A railroad, on the other hand, is generally obligated to supply basic transportation equipment.

With respect to all-door boxcars, a railroad may or may not consider such equipment "specialized" and may or may not supply such equipment when performing service as a common carrier. Under the Interstate Commerce Act, the railroads are obligated to supply "adequate car service" which generally means that basic, sound equipment will be provided for transportation service. Whether a particular railroad is obligated to provide "all-door boxcars" is dependent on whether it holds itself out to do so.

Question 5. If the railroads do not consider that they need to furnish their shippers with specialized cars, shouldn't their shippers be permitted to tender traffic in such equipment assuming, of course, it satisfied AAR and DOT specifications?

Answer. Generally, if a railroad cannot furnish transportation equipment to a shipper, that shipper should be able to use its own equipment. But, if the railroad provides transportation equipment that is adequate for the transportation need, the railroad is entitled to require use of that railroad-provided equipment. Since the railroads have an *obligation* to supply transportation equipment, they also have the concomitant *right* to supply that equipment. The fact that a shipper may perfer to use a particular type of car for his own convenience does not extinguish a railroad's obligation and, therefore, its right to provide adequate railroad-owned equipment. For example, if a railroad provides equipment suitable for loading a particular shipper's traffic, such as boxcars for shipments of lumber, and a shipper wants to ship his lumber in all-door boxcars which the railroad does not provide, the railroad still has a right to provide that equipment it holds itself out to provide, namely any boxcars or other car types suitable and adequate for use in transporting the commodity.

Question 6. If they should be permitted to tender traffic in such equipment, would it not be reasonable and equitable that the shippers be compensated, by way of rate reductions or, alternatively, the receipt of allowances?

Answer. It is reasonable that a railroad should recognize the value of the railroad of a shipper providing its own equipment. But if the railroad is prepared to supply railroad-owned equipment for use in the transportation of such traffic, the value of any shipper-supplied equipment may be negligible. The railroad incurs large investment costs for equipment that it has purchased or leased, and use of shipper-owned cars may not represent any appreciable cost-savings to the railroad if its own equipment remains idle. In addition, the marketplace determines the level of freight rates a railroad may establish for the transportation of particular traffic. The value of a shipper-supplied car is also established by the marketplace. If more cars are available than are needed for transportation needs, that is, if supply exceeds demand, the value of such cars will be less than if demand were high.

Question 7. Wouldn't the railroads be spared ownership costs—their investment in such equipment, major repairs and the like—insofar as transportation were rendered in shipper-owned equipment?

Answer. In those circumstances where a railroad has not furnished suitable transportation equipment and the shipper is willing and able to do so, the shipper-provided equipment represents something of value to the railroad. The exact value is determined by the marketplace. Of course, where a railroad has made the necessary investment in cars, the railroad is not spared the bulk of ownership costs regardless of the existence of shipper-provided equipment.

Question 8. Wouldn't a discriminatory situation develop if the railroads rendered contract or exempt transportation at identical charges for shippers furnished railroad-owned equipment, on the one hand, and, on the other hand, shippers providing their own equipment?

Answer. There simply can be no generalized finding of unreasonable discrimination solely based upon identical charges for transportation provided in railroad-owned or shipper-owned equipment. Pursuant to the contracts provision of the Interstate Commerce Act, 49 U.S.C. 10713, an agricultural shipper may file an unreasonable discrimination complaint only if it demonstrates that it will be individually harmed because of a refusal of a rail carrier to offer it a contract "for rates and services for the transportation of the same type of commodity under similar conditions" to a contract at issue and "at a time essentially contemporaneous" with the contract at issue. Whether a discriminatory situation would develop if a railroad rendered contract transportation at identical charge for railroad-owned equipment and shipper-owned equipment would necessarily depend on whether the *entire* terms of *specific* contracts being compared would satisfy the "similar conditions" requirement of Section 10713. For example, if one contract at issue involved different services, different commodities, different origins and destinations, different minimum volume guarantees or other dissimilarities—including differing competitive conditions attending the provision of the service (see, e.g., *Dresser Industires, Inc.* v. *I.C.C.*, 714 F.2d 588 (5th Cir. 1983))—in terms and conditions from another contract, there could be no finding of unreasonable discrimination under Section 10713 based solely on whether railroad-owned or shipper-owned equipment is being furnished. Moreover, as discussed in response to question 6, use of shipper-owned equipment may provide negligible cost-savings to a railroad where railroad-owned equipment is available, and in such circumstances the rate offered by the railroad will reasonably reflect such economic consequence.

Finally, the discrimination provisions of the Interstate Commerce Act are not applicable to exempt transportation, so that there can be no finding of unreasonable discrimination under that Act with respect to such traffic.

Senator PACKWOOD. As I was listening to you, Mr. Thompson, talking about Chairman Gradison and how they are always going to start and always going to start, I could not help but think of Churchill's famous phrase. "This is not the end. It is not even the beginning of the end, but it is, perhaps, the end of the beginning.

Give me your response to Mr. Dempsey's argument that even under the CURE formula there are no revenue adequate railroads.

Mr. THOMPSON. Mr. Chairman, my response to that is twofold. Very simply, I have not made those calculations. That may well be so. If that is so, fine. It is a sensible formula. I see no complaint. I would gather from that that Mr. Dempsey says, fine, go ahead and enact it, so I would suggest you do that, Mr. Chairman.

It is a sensible formula. It uses real costs incurred by the railroad. It does not permit a return on deferred taxes, so if it falls out that way, fine, but I will guarantee you, sir, that if none are revenue adequate they will be a lot closer to it than under the ICC.

The time will come when they will be revenue adequate. I think that demonstrates the reasonableness of the proposition before the committee here.

We do not propose this CURE legislation as a panacea or as a cure-all. As the chairman of the ICC said, the revenue adequacy determination is not the whole thing. That is just one part of it. We just want to get away from being totally absurd to having some bearing to reality.

Senator PACKWOOD. Is it true that you, on behalf of your company, if you are arguing cases to a rate commission, argue that the cost of capital is a fair indicia against which to be measured?

Mr. THOMPSON. Of course. The cost of capital—Mr. Dempsey, I cannot believe as smart a fellow as Mr. Dempsey is, he does not understand this. He says he never understood how the utility position on cost of capital differs from his. He surely understands it.

It is a simple matter, Mr. Chairman. We all agree that you ought to earn or have an opportunity to earn the cost of capital. The question is, what is it? How do you compute it? Mr. Dempsey and the ICC would compute it with a fantasy determination because it was costs that did not actually occur but might have occurred if you had invested currently, but we deal with actual costs.

Senator PACKWOOD. You mean the answer is it is OK to base it on the cost of current capital?

Mr. THOMPSON. It should be based upon the cost of current capital. Here is the point, Mr. Chairman. I have to be more specific. But you base the equity portion on the current cost of equity, and that is a judgmental matter. It creates a lot of testimony. But you base it on cost of what you actually pay for the debt. If we have a cost of debt that is $100 million, that is what we ought to be allowed, not $200 million because it would be higher if we were to finance now. That is the difference.

Senator PACKWOOD. All I want to find out is whether the answer is yes, it ought to be based on the cost of the current capital.

Mr. THOMPSON. The real cost of capital.

Senator PACKWOOD. We can argue whether it is figured right or not, but you gave me the impression you wanted to have it based upon the embedded cost of capital invested 40 years ago.

Mr. THOMPSON. That is correct, sir, on the debt portion, of course. Why should they recover anything different? That is all they have got to pay. That is all we ever recover, all the electricity utility ever recovers anywhere in the United States. The rates we charge you for your electricity do not include in there some extra money that we do not pay out for debt. It includes what we actually pay for interest. That is what it should include.

Senator PACKWOOD. Now, tell me about these cases to which reference has been made, these eight cases the Department of Energy looked it. Did Edison Electric Institute pick the cases?

Mr. THOMPSON. I think it did, Mr. Chairman. They are appended to my testimony, and we stand by every one of them. Of course, the ICC said we are going around in a circle. The ICC said they are flawed because they used the same flawed methodology.

Senator PACKWOOD. Slow down. Just answer my question for a minute. Did the Edison Electric Institute pick the cases?

Mr. THOMPSON. I think it did, sir. I am not sure. The first eight may have been picked by the Department of Energy. I am not sure.

Senator PACKWOOD. Did the Department of Energy conclude, as Mr. Dempsey said, and I am quoting, "the average coal rates have increased less than 0.5 percent a year when adjusted for inflation"?

Mr. THOMPSON. I am not sure it concluded that from those cases. I do not believe so. They concluded that in general about coal rates, the average rate.

Senator PACKWOOD. Who started this? Did DOE initiate the study on its own, or did the Edison Electric Institute ask them to do it?

Mr. THOMPSON. I am not certain about that, Senator. I do not have that history in my mind. I am not sure.

Senator PACKWOOD. You do not know if they dreamed it up themselves or if somebody asked them to do it?

Mr. THOMPSON. I do not know that, no, but I know I stand by those 19 cases. I stand by the validity of it, which shows a return on those captive shipments of from 50 to 157 percent return on capital on those shipments. I stand by the computations. They are attached to my testimony.

Senator PACKWOOD. Senator LONG.

Senator LONG. Excuse me. Senator Rockefeller was here first.

Senator ROCKEFELLER. I think the answer to your question, Mr. Chairman, was that Secretary Hodel started that on his own motion.

Mr. Dempsey, you are an expert in transportation. You would not, or would you, feel that as a matter of public policy, substantial quantities of coal should be carried by truck?

Mr. DEMPSEY. As a matter of public policy, it should be carried by truck if that is the most economic, cost-efficient manner and way to transport it.

Senator ROCKEFELLER. In Kanawha County, which is the capital county of the State of West Virginia and a major coal producer, about 6 or 7 million tons were produced in 1984. Now, the country has gone from a 1983 figure of about 2,000 railcars a day down to about 176 these days, the slack fundamentally having been picked up by trucks.

Do you have any reaction to that as to what might have happened?

Mr. Dempsey. I would be glad to look into it, Senator. My assumption is that for one reason or another, the trucks could carry that freight more cheaply than the railroad.

Senator Rockefeller. Would there be any reason that you could conclude that from the greater cheapness of trucks? Does it have anything to do with the cost of rail transportation, for example?

Mr. Dempsey. Certainly. I mean, it has to. I assume at least that it has to. I assume that the shipper is picking the cheapest way that he can find to transport his freight.

Senator Packwood. May I ask you a question? I want to make sure I understood what you asked, because I did not realize this situation existed.

Do you mean great quantities of coal are hauled by truck?

Senator Rockefeller. Yes, and increasing quantities in a very short period of time, during the period in which the ICC has unfolded. The West Virginia Coal Association feels that one of the reasons for that is the noncompetitive rail rates.

Senator Packwood. Again, this is news to me. In other words, in this particular county you are referring to, the coal industry is not captive to the railroads? They have an alternative method of shipping?

Senator Rockefeller. Yes. You make a point, Mr. Chairman, with respect to that. I make a point with respect to going from a 2,000 railcars a day down to 176, even though the trucks have been there for years.

Senator Long. May I just make a point, since this just came up, and suggest that the fact that coal could be hauled any distance on trucks is to me absolutely ludicrous. It is funny, if I can say it, that anyone would even talk about hauling coal in quantity by trucks. Next they are going to talk about hauling it on airplanes, I suppose.

Mr. Dempsey. If I may suggest this, I can easily provide you national data and, of course, not very much coal in the Nation is carried by truck. It is a very, very small percentage, and in those cases, there are usually special or always special circumstances.

I make the final point that truck transportation in general has been subsidized by the Federal Government in a very important way. Under the most recent increase in motor carrier heavy truck taxes, they are still, according to the Department of Transportation, paying only 60 percent of their fair share.

Having said all that, I would be glad to look into that particular case. There must be unique circumstances there, because that is not a pervasive situation in the United States.

Senator Rockefeller. Thank you.

In March 1985, Forbes Magazine said, and I just want to know if you agreed with it or not, that coal is an enormously profitable commodity for the railroads and provides only 22 percent of the in-

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dustry's $27 million in revenues but probably a third or more of its profits.

Mr. **Dempsey**. All that I can do there, Senator, is whether it is enormously profitable is obviously a judgment call. All I can do really is to repeat what I said before, and add this to it. Coal is our No. 1 commodity in terms of tonnage. It represents roughly 40 percent of our tonnage. It represents much less of our revenue, as I recall, about 27 percent of our revenue, something in that range, so that the revenue is not proportionate to the tonnage.

Still, in terms of cost, the only available data, at least to me and I think to you, is the ICC published data that shows that in terms of profitability, coal is carried on average at 146-percent revenue-to-variable cost. That puts it about six; that is to say, there are about five or six major commodities that are at that level or above, so it is no more profitable than much of our other traffic so far as anyone can tell.

That does not mean it is not profitable. I am not suggesting that. Without coal the railroads would be out of business. No question about that at all.

Senator **Rockefeller**. With respect to revenue adequacy, I asked Chairperson Gradison whether or not the ICC rulemaking dealt with either the current cost of debt issue or the issue of deferred taxes.

I speculate, that if these two issues were treated differently, in fact major railroads would all be found to be revenue adequate. Would you agree with that?

Mr. **Dempsey**. I would disagree with that, and I will give you the figures if you would like, using that calculation on any railroad, any major railroad, that you choose.

Let us take the Norfolk Southern system, for example. Taking deferred taxes out of the investment base and using the embedded cost of debt, the Norfolk Southern system would have earned in 1984, our best year in over 30 years, 9.06 percent.

Using the embedded cost of debt instead of current cost of debt as the target, the target would be about 15 percent, so that is 9 percent measured against a target of 15.

You have the figures. We have given them to you already in my letter to the chairman, but you have them all and that is the point I was making before. I do not mean that these are insignificant issues, and I do not mean that they are not debatable issues, but the argument cannot be made that if you resolve them all in favor of the CURE bill that any railroad would be revenue adequate. It simply would not be.

Senator **Rockefeller**. Thank you, Mr. Chairman.

Senator **Packwood**. Senator Long.

Senator **Long**. Mr. Thompson, you are here speaking for a coalition. I think it is fair to just note who you happen to be. I know who you are, and I feel as if I am a friend of yours. My wife is a friend of your wife. In fact, I think they both come from North Carolina, and so it has been my privilege to know you down through the years.

You have appeared on occasion testifying for the entire investor-owned electric industry, have you not?

Mr. **Thompson**. Yes, sir.

Senator Long. You go to a convention at least once a year where you discuss problems with all of the investor-owned electric utility people, and you are familiar with their problems that exist all over the United States because they talk about them at those conventions, do they not?

Mr. Thompson. Yes, sir.

Senator Long. You represent and have testified repeatedly about an industry that is closely regulated, is that right?

Mr. Thompson. Yes, sir.

Senator Long. I must be fair and tell you that in my State I do not think that the regulation is fair as far as your industry is concerned. I think it is too tough. My father, Huey Long, started that tradition, I suppose. They called it the Railroad Commission back at that time, but he got his start being tough on the utilities, rolling back rates and that sort of thing, and others have sought to follow that example.

For example, I knew a fellow named Jimmy Davis who was elected Governor on two different occasions. He got his start on the Commission. John McKithin, a law school classmate of mine, served as Governor twice. That is where he got his start.

Invariably the way to get somewhere, it seems, is to be a tough Commissioner and not vote for increases and even vote to cut them and roll them back, so much so that I have had the chairman of the AT&T come to me and say, Senator, we just do not think we are being treated fairly in your State. The only chance we have to get any justice is to go to court.

I was told one time that people who were being regulated said that the Commissioner—and I am not going to name him because it might not reflect credit on him—told their company, I gave you fellows a break. What break? You voted against us. He said, yes, I know, but we voted you down and said that you are not entitled to any relief. That gives you the right to go to court. We could have fiddled around with that thing for 2 or 3 years before you had a chance to go to court.

That is about the experience we have had in Louisiana. You have to go to court to have any chance at all, and even then those judges have to run for office and they are scared to reverse the Commission. So they have had a tough time in Louisiana.

You are familiar with all that goes on in America around the whole country, are you not?

Mr. Thompson. Yes, sir.

Senator Long. So you are up here saying, look, if we are going to do justice by customers here in the Washington area, just as an example, and you are familiar with that, we have to buy the coal at a reasonable price because all that has to be passed through to the customer in the price of the product, and what you have here is utterly ridiculous.

Mr. Dempsey comes and says well, if we passed your bill you still would not get any relief. You say, well, maybe so, but at least we would have a chance. If we are right, we would have a chance to win. The way it stands now you do not have a chance to win even if you are right. Basically, that is what you are saying here.

Mr. Thompson. Exactly, Senator.

Senator LONG. You are saying this is utterly ridiculous. We are regulated. Do it like you do it to us, and then we know how they once were regulated. We know how we are regulated, and all we are saying is this is patently ridiculous.

Now, can you imagine anything as silly or any commission being as inept as to take all of this time to get rid of this issue—what do they call it, where you have to prove that the rate is less than what it would cost you to build your own railroad? You start out here and say what would it cost. What do they call that standard?

Mr. THOMPSON. The stand alone cost.

Senator LONG. Nowhere else in the law does it exist, where you take them into court or to the Commission and you are put through this foolishness of saying, look at what would it cost us to condemn our way, tear all the houses down between here and the District line and then condemn our way on through Maryland to build ourselves a railroad?

You cannot use airlines. You have to condemn your way through the District of Columbia and on out through the metropolitan area of Washington, cut your way through the mountains. You cannot use the low land that Norfolk Southern has there to grab up first. No, you have to take what is left to go on out through Maryland and West Virginia over there somewhere into Kentucky to bring some coal over, you have to go through all the cost of completing that.

What on God's green Earth should that have to do with the rate that Norfolk Southern, for example, should charge you to haul coal?

Mr. THOMPSON. The answer is nothing, Senator. I agree with you 100 percent.

Senator LONG. As long as this Commission insists upon having that in their standard, that proves either their total ineptness or total unfairness, it seems to me.

Mr. THOMPSON. Or both.

Senator LONG. Or both, and that is one point you made. If this committee cannot see that, it seems to me this committee just does not want to be fair with you. What did you say is the only thing you are trying to change about the Staggers Act, in the act itself?

Mr. THOMPSON. The burden of proof, sir. It may be a minor change but the only significant substantive change in the Staggers Act is the burden of proof on rate reasonableness.

Senator LONG. Every rate you file—is this correct? For every rate you file and every rate that is filed anywhere in America for your industry, your industry has the burden of establishing the reasonableness of that rate?

Mr. THOMPSON. We do, and appropriately so, sir.

Senator LONG. What about the railroads? Up until we passed the Staggers Act, did they not have the same thing?

Mr. THOMPSON. The same burden.

Senator LONG. So they are familiar with it. Can you imagine anything as ridiculous as calling upon a fellow out there in Timbuktu and telling him to try and prove that the rate is reasonable or not reasonable? He does not have the books. He does not have the information. The other guy has it.

Mr. **Thompson**. No, sir. It is difficult enough for a company with resources. As I say, it costs hundreds of thousands of dollars, but a small shipper is out of court. There is no way a small shipper can go to a commission with such a proof of that. Under the Staggers Act, Senator, the burden is on us, not on the railroad. That is the change we think should be made.

Senator **Long**. That is what you have to contend with everytime they take you to court, is that right, anytime anybody challenges you?

Mr. **Thompson**. When we file a rate we have to defend it and prove the reasonableness of it in the electric industry rather than have our customers disprove the reasonableness of it.

Senator **Long**. That is the only rule change that you are asking for?

Mr. **Thompson**. That is the only change in the substantive wording of the Staggers Act. The rest of it is administrative requirements that the Commission could have done and should have done but did not and will not, sir, unless this Congress does something about it.

Senator **Long**. Thank you very much.

Senator **Packwood**. Senator Danforth.

The **Chairman**. Mr. Dempsey, you said that prior to the Staggers Act the railroad industry was on its last legs. Now that we have had the Staggers Act for 6 years, is it robust and healthy and booming, and is it one of the big, prosperous industries in America?

Mr. **Dempsey**. No, it is not, Senator.

The **Chairman**. Does it have maybe some pockets of weakness?

Mr. **Dempsey**. In general, this is our situation. We realized a rate of return, as I said, in 1984 of 5.7 percent on investment as against a target of about 15 percent. That is the average. Of course there was only one railroad, the Burlington Northern, that hit double digits. It was around 10 percent, and so every railroad—but still, as I say, that is the best year that we have had in 30 years.

On the good side of it, we have made record breaking capital expenditures. We do not have any or hardly any deferred maintenance on our mainline system now. Our plant physically is in excellent condition, I think.

But the fact remains, and you know one can disagree, I suppose, but it is hard to disagree with the figures, even on the CURE legislation figures. Every major railroad in the United States must improve its profitability over the long run in one way or another, and that has got to be, I think, in my personal judgment, by way of cost control, so that is where we are.

I think it was GAO that put it, when they looked at the profitability of the industry, we are making on average now what you would get in a NOW savings account, and that is where we are. We are by no means out of the woods, but at least the Staggers Act has given us an opportunity to look forward to the possibility of a profitable and well-maintained rail system.

The **Chairman**. You said that since the Staggers Act coal rates have gone up. What percent?

Mr. **Dempsey**. On average 0.4 percent per year.

The **Chairman**. Since the Staggers Act?

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Mr. **Dempsey**. Since Staggers. That is due primarily to the first year when there was a catchup period. If you look at the last 3 years, they have gone down.

The **Chairman**. They have gone down?

Mr. **Dempsey**. Right, in real dollar terms.

The **Chairman**. What has happened to electric utility rates?

Mr. **Dempsey**. They have gone up much more sharply, and all of those figures are contained in my testimony.

Mr. Thompson's company, for example, in 1980 by my figures, was earning 12.2 percent, and in 1984, it was earning 16.6 percent when it asked for an $80.1 million rate increase.

That has been a problem for us because it seems to us—perhaps I am wrong—but it seems to us that CURE and the utility industry in particular has pointed at coal rates by way of explanation as to the rapid escalation in utility rates, and that case simply cannot be made.

I have repeatedly pointed to the fact that coal rates have gone up much less rapidly than utility rates. Mr. Thompson and his associates do not like me to do that, and I do not mean to suggest that their profits are unreasonable, not by any means. I am glad they are profitable, but as long as they keep suggesting that we are the cause for this escalation of utility rates, I will have to respond that we are not.

The **Chairman**. Do you think coal rates are going up too fast, Mr. Thompson?

Mr. **Thompson**. Senator, in my company in the last 6 years, the cost of the coal has only gone up 2.4 percent. The freight rates to haul that coal have gone up 80 percent.

The **Chairman**. Eighty percent?

Mr. **Thompson**. Eighty percent and, yes, sir, I think that is too fast, and we have filed cases before the ICC which have not been heard.

The **Chairman**. How do you compare the 80-percent increase versus the 0.4 percent annual increase of Mr. Dempsey?

Mr. **Thompson**. I will tell you exactly how I compare it. An associate of mine compares it in this way, Senator. Mr. Dempsey is talking about average figures. Averages do not tell you a thing. It is the old story.

My associate says a man can be drowning in a 7-foot hole when the average depth of the lake is 1 foot. That is the answer to it. Averages do not tell you. The averages cover all of the competitive rates and everything else. In my case, they have gone up 80 percent. That we know. Mr. Dempsey's testimony says he does not check that out but he believes it.

Since my company has been alluded to, I want to make one other point, Senator.

The **Chairman**. No; I want to make my point now. What is your response to Mr. Thompson, Mr. Dempsey?

Mr. **Dempsey**. We have the figures with respect to his company in our testimony, and I will stand by those figures. With respect to our transportation rate increases, we think they have been reasonable. Again, I will point out that——

The **Chairman**. Mr. Thompson says there has been an 80-percent increase for his railroad.

Mr. **DEMPSEY**. Our cost went up 68 percent in that period of time, and so it is an 80-percent increase in rates as against a 68-percent increase in our cost, which seems to me not to be unreasonable.

Giving you overall figures between 1981 and 1984 for the utility industry, fuel cost increased $842 million. Their revenues went up $24.4 billion. Their retained earnings just about doubled. Their dividends to stockholders just about doubled.

The **CHAIRMAN**. Thank you, Mr. Chairman.

Mr. **THOMPSON**. Senator Danforth, may I make one observation? Since you alluded in your question to the fact that electric rates have gone up, I think I should complete this by saying the electric rates in my company during the same period have gone up 32 percent, and inflation is generally up 43 percent, while the freight rates went up 80. That should be in the record.

Senator **PACKWOOD**. Senator Kassebaum.

Senator **KASSEBAUM**. Thank you, Mr. Chairman. Mr. Dempsey, I appreciate your comments. I know that the railroads and the National Grain and Feed Association have tried very hard to come up with a compromise, and I appreciate your comment that maybe it could be fine-tuned a bit further to meet some of the concerns.

I would just like to ask you, in going back to the earlier contract summary that I gave an example of when I was questioning Chairman Gradison. Would a Kansas shipper that sells wheat to gulf ports be able to determine whether he is affected when he cannot determine whether the contract applies to another shipper near his location or to a shipper that is located across the way in another State?

Mr. **DEMPSEY**. I did negotiate the agreement, but grain transportation is not an area in which I am personally familiar. As I understand it, though, this was the complaint of the National Grain & Feed Association.

They are providing, however, that their specific point of origin and destination be identified. At least the Grain & Feed Association people felt that would have put a shipper in a position to know whether or not he might be affected, and that gets him to the point then of being able to secure the details. It is their judgment, and they know a lot more about it than I.

Senator **KASSEBAUM**. Perhaps it needs to be clarified as far as it ought to be spelled out in the contract.

Mr. **DEMPSEY**. As I say, we are glad to work with all interested parties. I agree with you that the Staggers Act did provide agricultural shippers with the right to make discrimination claims. They are the only people that have that right, and therefore they are entitled to the disclosure that is necessary for them to know whether or not they have a case.

Senator **KASSEBAUM**. In the compromise to address more specifically origin and destination stations, transit points are not specified.

Mr. **DEMPSEY**. Yes.

Senator **KASSEBAUM**. I would like to ask you why these are treated differently.

Mr. **DEMPSEY**. Could I respond for the record on that, Senator?

[The following information was subsequently received for the record:]

Origin and destination stations are required to be identified in the contract summary. If a shipper decides that, based on information in the summary, it is "affected" by the contract it can request the carrier to provide additional information including, among other things, the identification of transit points.

Senator KASSEBAUM. Yes.

Mr. DEMPSEY. We did discuss that. That was an issue that was part of the negotiations, but frankly I personally cannot recall at this moment exactly what the basis was.

Senator KASSEBAUM. I would appreciate that. Thank you.

I guess the only other question I have, Mr. Chairman, is why was the identification of a shipper so onerous to the concept of railroad contracting?

Mr. DEMPSEY. I think probably the parties to whom to address that question are not the railroads but the shippers. It is, for the most part, the shippers that do not want their identity disclosed.

Now that you mention that, Senator, it is my recollection, which I will confirm, that the reason the transit points were not included was because in many cases that would, by itself, disclose the identity of the shipper. I think that that is the case. As I say, I will check that out.

It is not unusual after all, because in the rest of American industry and business that is the situation. Other enterprises do not publish on the courthouse door the names of the people with whom they have made contracts.

Again, it is simply a matter of the Staggers Act tried to push the rail industry into the same kind of format as much as possible as the rest of American business. An exception was made for agriculture, but by and large confidentiality is desired by most shippers.

Senator KASSEBAUM. As you probably know, Senator Symms has a bill that he has introduced that would make public disclosure immediately on filing for all agricultural products and forest products. I think, personally, that takes it a step too far, but it does seem to me that there should be just a reasonable way to deal with this. I personally find it very difficult to see why it is apparently so onerous. As you say, it is more the large shippers who do not want to divulge their names.

Thank you, Mr. Chairman.

Senator PACKWOOD. Senator Long.

Senator LONG. Mr. Thompson, it always seems to me that when someone brings into the argument something that is totally irrelevant, it is tantamount to a confession of the weakness of his own case.

As far as your industry is concerned, if your rates are too high—if no one here has made the statement and if they want to make it, I invite them to make it—is it that the laws are not adequate to permit consumers to challenge your rates?

As I say, in Louisiana I think it is probably the other way around. You are the ones who have a right to complain, as you have great difficulty in your industry winning your case and eventually getting what you are entitled to, even when you have a good case.

I do not know of anyone contending here that the electric utility industry is making too much profit, and that the laws are not adequate to challenge it. What you are complaining about is that in trying to serve your customers this law is not adequate to let you do the same thing to them that anybody can do to you, which is to challenge the rate.

If you are able to succeed, let us say, and Potomac Electric Power Co. were to win a case to cut the rates for the hauling of that coal for these plants here, how much of that money would Pepco be permitted to keep?

Mr. THOMPSON. None, Mr. Chairman. Please permit me to comment on that in light of your initial comment. We would be permitted to keep none.

I was astonished at Mr. Dempsey's filed testimony. If you have not read it, I would urge you to read his testimony because here is what you will find, sir. What he says is astonishing.

His testimony reminds me very much of a rape case. I do not mean to say there is any analogy between freight rates being charged to utilities and a rape case. It reminds me, however, of a rape case in the sense that he had tried to draw attention away from the exorbitant nature of the freight rates by attacking the victim, us, which is strange. We are his best customers.

He has attacked us, and he said this. Here is the most curious thing he said. Read it. He said the utilities say that not a nickel of profit is allowed to be earned on freight cost, coal cost, fuel cost. Here is what he says. He says that is literally true. These are his words. That is literally true. He says, however, I have been pondering that and there is something wrong with it.

He says it is literally true, but what I deduce is that from Mr. Dempsey's long association with railroad executives it is inconceivable for him to think that an executive of a company could be here in the consumer's interest. That is what he said.

He said there is some other explanation for Pepco's interest in these rates other than what is literally true, and here is what he concludes it is. It is the most astonishing thing I believe I have ever read. Here is what he says. He says he has finally hit upon the answer after puzzling about it. He says, everything you can save on freight rates the regulatory commissions would allow you to add to your profit.

Now, there is a regulatory commissioner here today. He is going to speak to this body. I will tell you, Mr. Dempsey, there is not a regulator in the United States, not one, or no case ever decided where a regulator would allow you to increase your rate of return because of cost savings. It is a perfect absurdity, of course, Mr. Chairman.

Senator LONG. Let me ask you this, if this is true. If you are paying too much for that coal and one of your customers comes in here challenging your rate, if that commission is worth its salt or that judge does his duty as a judge when it gets to that court, is it not their duty to order you to cut that rate because the rate is too high?

Mr. THOMPSON. Of course.

Senator LONG. Rather than stand there while you are compelled to rape your customer because they are raping you?

Mr. THOMPSON. Even if we had no interest in our customers, which Mr. Dempsey says must be the case, it is inconceivable. Even if he is right, it certainly is in our own interest to keep the cost down because our regulatory commissioners scrutinize all the costs which we incur and want to be sure that they are incurred properly and that we do not overpay any of them.

Senator LONG. I am sure that we must be in error if we think that Mr. Dempsey would criticize you for protecting the interest of your customers. Just in case there is any doubt about it, do you feel that you have a duty to protect the interest of your customer?

Mr. THOMPSON. We do. We do, Mr. Chairman.

Senator LONG. That is what you are doing here. That is why you are here, is that right?

Mr. THOMPSON. In addition to which this coalition consists of the Consumers Federation, rural electric cooperatives who have no stockholders and no profit motive and other people in electric utilities here who have the same consumer interest.

Senator LONG. What you are doing is what the law requires you to do when you are being charged too much and being forced to charge it in turn to your consumers, is that correct?

Mr. THOMPSON. That is exactly correct, Senator Long.

Senator LONG. Just so we can understand, what you are doing here is not seeking to make more money for the shareholders of the private electric utility industry. You are performing a duty to try to see to it that the customers of that industry receive a fair rate?

Mr. THOMPSON. That is correct.

Senator LONG. You are also at this point speaking for a great number of little people out there who are not as well placed as you are and do not understand the issue perhaps as well to explain what this thing is all about. Your view is that you are effectively regulated in your opinion, and you think that in this particular case a captive customer is being required to charge a rate too high to his consumer because he is being charged too much, and are seeking to bring the rate down so you could reduce yours.

Mr. THOMPSON. Exactly.

Senator LONG. Thank you very much.

Senator PACKWOOD. Gentlemen, I have no other questions. Thank you both for coming. We appreciate it.

Mr. DEMPSEY. Mr. Chairman, one final point, with your permission, because this is the first time it has been said. Mr. Thompson and I continue to astonish one another, but the point was made that the only change in Staggers would be the burden of proof.

Just to make the record perfectly clear on this: One, Staggers did not change the burden of proof in maximum rate cases; and two, the burden of proof in maximum rate cases in investigations by the Commission is on the railroad. It is only in complaint cases where the complainant, in asking for an investigation, has failed to make a prima facie case that the burden is on the railroad.

That is simply a matter of fact, and I wanted the record to reflect that, with your permission.

Senator LONG. Let us just understand this because this is very important and, Mr. Thompson, I will not ask you this question.

Let us agree that the way it stands right now the burden is not where it should be, and that is what we are trying to do, put it where it should be. Is that not correct?

Mr. THOMPSON. That is all there is.

Mr. **Dempsey**. If it is not where it should be, then the change would be to put it on the shipper in investigation cases, because it is on the railroad now in investigation cases.

Mr. **Thompson**. Oh, no, Mr. Chairman. Let me correct that. If the ICC itself initiates an investigation, it puts the burden on the railroad, but who thinks they are going to do that, for crying out loud, Mr. Chairman?

There is no remote possibility of that, so for all practical purposes every case that we complain about or every case in which they file a new rate, unless the ICC itself does not like it the burden is on the shipper. That is all.

Senator **Long**. So as a practical matter it means that in 100 percent of the cases, as it is and as it has been since this law passed, in 100 percent of the cases the burden has been on the shipper.

Mr. **Thompson**. One hundred percent, sir.

Senator **Long**. Thank you.

Senator **Packwood**. Gentlemen, thank you.

[The following information was subsequently received for the record:]

Association of American Railroads,
April 11, 1986.

Hon. Bob Packwood,
Chairman, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

Dear Mr. Chairman: I am writing to supplement the record of the February 21 hearing on S. 477. In my oral testimony I stated that, excluding the recyclable and section 229 cases, there had been only 17 complaints involving rates filed since the enactment of Staggers. (The excluded categories involve cases which were, in effect, created by Staggers.) I was making the point that the filing of only 17 complaint cases over a period of more than 5 years lends scant support to the charge that the railroads have been abusing any ratemaking freedom under Staggers. A list of the cases to which I referred is enclosed for the record.

In the course of questioning me, Senator Rockefeller suggested that in at least one instance in West Virginia increased rail rates caused the diversion of coal traffic from rail to truck:

In Kanawha county, which is the capital county of the State of West Virginia, it is a major coal producer in 1984. They produced about 6 or 7 million tons there. Now, they have gone from a 1983 figure of about 2,000 rail cars a day down to about 176 these days, the slack fundamentally having been picked up by trucks.

Do you have any reaction to that as to what might have happened?

Because of the availability of barge service to the Ohio River via the Kanawha River, I am informed that a significant amount of coal does move via truck to the river. The figures available to me indicate, however, that the total amount of coal moving by rail out of Kanawha County has not changed appreciably between 1983 and 1985 so that the total carloadings should not have decreased and, certainly not in the magnitude stated by Senator Rockefeller. His figure of 2,000 cars a day would yield, depending upon the size of the car, anywhere from 40–70 million tons of coal a year whereas, as he notes, the production figure for the county is only around 6–7 million tons.

With regard to Mr. Thompson's testimony in behalf of C.U.R.E., you will note that it was virtually identical to the testimony which was presented to the Subcommittee last November by Mr. Mitchell in behalf of the Edison Electric Institute. I examined the flaws in the latter at some length in my letter to you of December 19, 1985. Needless to say, the E.E.I. testimony gained nothing in accuracy by virtue of its repetition in behalf of C.U.R.E.

The utilities continue to profess that it is only an abiding concern for the consumers of electricity that motivates their assault on rail coal rates—rates which, in constant dollars, have been below their 1972 level in 12 of the last 13 years. As we noted in our analysis of the electric utility industry of July, 1985, if the increase in the delivered price of coal in current dollars between 1981 and 1984 had *all* been attributable to increased rail rates, the increased cost per kilowatt-hour would have been less than 3/100 of a cent. Because the price of electricity increased 35 times that much in the 1981-84 period, the over-riding concern of any informed consumer of electricity would have been utility profits, not rail coal rates.

Just how well the utilities have been doing at their consumer's expense becomes clearer every day. I am enclosing an article which appeared in the Wall Street Journal of March 26, dealing with the "cash cow" status of the utility industry and the consequent rush to diversification. A few of the items:

Consolidated Edison is creating an investment company to handle $300 million of excess cash;

Pepco's excess cash is being put to work through Potomac Capital Investment Corp., an entity created to engage in leveraged equipment leasing and preferred stock purchases;

Dominion Resources, Inc., (VEPCO's recently created holding company) has gone into the business of buying and selling commercial paper;

Minnesota Power and Light has gone into the stock and bond investment business, deriving one-third of its 1985 net income from that source.

Finally, I would like to offer a few comments on the testimony of the National Association of Regulatory Utility Commissioners which was presented by Branko Terzic. That testimony contains not the slightest suggestion that, if left to their own devices, state regulators would regulate intrastate rail transportation with any concern for the welfare of the carriers who provide that transportation. Rather, their interests plainly remain, as for decades prior to Staggers, the subsidization of intrastate rail movements at the expense of interstate rail movements and railroad investors.

While the state regulators are supposedly now applying federal standards in regulating railroads, their testimony betrays a distributing lack of familiarity with the content of those standards. Nor do they yet comprehend the need to apply different standards in regulating total monopolies such as electric utilities and firms such as railroads with limited market power.

For example, they still do not understand that railroads have to price their services differentially and that cost-based rate regulation such as they apply to utilities would drive the railroads to bankruptcy. Thus, at page 2 of their written testimony, the state regulators state:

[T]he ICC refuses to regulate rail transportation rates using standards which have any relation to the costs of providing service. A comparison of the ratemaking standards employed by the ICC concerning monopoly rail rates with comparable utility standards highlights the ICC's failure to adequately protect captive rail shippers.

Later, they assert that:

Once a utility's or railroad's revenue needs are determined, regulators must design rates to allocate those needed revenues among the consumers of the monopoly's services.

That is an incredibly benighted statement which suggests that the state regulators have not learned anything in forty years. Do they really believe that they each have a state full of captive railroad shippers and that they can set intrastate railroad rates so as to allocate to each of those shippers its share of the railroads 'revenue needs? One would have assumed that by now they could perceive the need to distinguish in their regulatory approach between electric utilities with monopoly franchises (to whom they virtually guarantee adequate revenues) and railroads operating in markets that are largely competitive (to whom they can guarantee nothing).

It is from such a premise that they move on to condemn the stand-alone cost concept—a concept which, it is quite evident, they do not understand:

The concept of stand-alone rail costs is functionally equivalent to a State commission allowing a utility to raise its rates to a homeowner until the rates reached a per kwh level at which the homeowner would construct his or her own generating capacity.

In fact, the functional equivalent would be to allow an electric utility to charge the customers it serves in its franchise area no more than an efficient competitor could charge for providing the same service assuming there were no barriers to entry. The states ought to try it—given the grossly uneconomic investment by many utilities in nuclear energy, many consumers of electricity would surely like it.

The state regulators are just as far off the mark in their criticism of the ICC's revenue adequacy standard:

In the following areas, the ICC has chosen to use accounting and regulatory standards far more favorable to rail investors than State commissions would permit.

In determining utility rate base, State commissions use the original cost of investment. The ICC calculates the rail "investment base" based on current or replacement costs. In an inflationary economy replacement costs are higher than actual historic costs, and therefore rail rate levels will be increased.

In calculating a utility's cost of capital, State commissions use the actual cost (interest rates) of embedded debt. Although the costs of embedded debt are readily determinable, the ICC calculates the cost of rail debt on the basis of current bond and interest rates, again overstating actual costs.

In determining the overall cost of rail capital, the ICC assumes a debt-equity ratio of 37:63, while most utility calculations fall in the range of 50:50. Since equity is more expensive that debt, the ICC's ratio serves to increase rail revenue needs.

As to the first point, the ICC does not calculate the investment base using "current or replacement costs." Like the state commissions it uses depreciated original cost.

As to the use of the current rather than embedded cost of debt, the answer is quite simple. The utilities are shielded from competition and are guaranteed revenues sufficient to cover debt expenses and the cost of equity capital. With 85-90 percent of its traffic subject to competition, the railroad industry is given *no* guarantee of a return on debt or equity. For that reason, the railroads should be treated like other businesses confronted by competition—all of which have the opportunity to earn the current cost of capital on both the debt and equity portions of capital invested in the business.

Moreover, as pointed out in the critique of the C.U.R.E. bill which was appended to my prepared testimony of February 21, if embedded debt costs were used in measuring the cost of capital, the railroads would always be forced to earn the lesser of the embedded or current cost of debt. This would occur because, when current debt costs fell below embedded debt costs, market competition would hold earnings to a level which reflected the current cost.

As to the final point made by the state regulators, the ICC does not "assume" a debt-equity ratio of 37:63 for the railroad industry. That ratio is calculated from the railroads' books and varies from year to year depending upon the fact. (If the railroads were again placed in the hands of the state regulators, presumably one of two things would occur—either their cost of capital would be determined as if the debt equity ratio were 50:50 regardless of the fact or, worse, they would be required to alter their capital structure to fit the regulators' molds.)

Beginning on page 8 of their prepared statement, the state regulators make their argument for ending the Federal preemption effected by Staggers and returning the states to their "historic role in regulating rail rates." The best argument against that proposition I have read lately is contained in the preceding seven pages of their statement.

I appreciate this opportunity to comment further for the record.

Sincerely,

Enclosure.

W.H. DEMPSEY.

MAXIMUM RATE CASES FILED SINCE OCTOBER 1, 1980, EXCLUDING RECYCLABLES AND SECTION 229 CASES

On February 14, 1986, the AAR requested its 11 largest member railroads to report all maximum rate reasonableness cases filed against them since the enactment of the Staggers Act other than the cases created by Staggers (the "recyclable" and "section 229" cases).

A total of 21 cases were reported. Three of the 21 were actually section 229 cases (because they involved rates in effect prior to Staggers and were brought within 180 days following enactment of Staggers) but the ICC failed to categorize them as such. Two cases involved the same issue. Consequently, of the 21 cases, only 17 involve complaints against rate actions taken by the railroads since Staggers—an average of 3 complaints per year.

The commodities involved in the 21 cases were:

Coal	12
Grain	1
Steel	1
Scrap Iron	2
Aluminum	2
Woodchips	1

The remaining 2 involved a switching charge and a rate for the movement of empty cars.

The disposition or current status of the cases is:

Railroad prevailed	1
Shipper prevailed	3
Undecided and no negotiations in progress	6
Undecided but settlement likely	2
Reopened for reconsideration under new guidelines	3
Voluntarily dismissed by parties	6

A brief description of the cases follows:

THE CHESSIE SYSTEM

Wheeling-Pittsburgh Steel Corp. v. *ICC* (ICC #38793)

In August 1981, the Chessie sought to raise certain intrastate rates to interstate levels. The PSC of West Virginia held for complainant. The ICC reviewed and reversed on the grounds that federal standards were not employed.

The Third Circuit upheld the ICC but remanded to determine the appropriate rate. Decision is pending before the Commission.

Cargill v. *C. & O.* (ICC #40021)

Cargill filed a complaint on July 31, 1985 challenging the level of a switching charge at Dayton, Ohio. No action in the case because the parties have been negotiating.

THE SEABOARD SYSTEM

Kentucky Utilities v. *ICC* (ICC #38809)

On March 26, 1981, the Kentucky Utilities Company filed a complaint against the Seaboard challenging its trainload rates.

The Kentucky P.U.C. held for the complainant, L&N appealed to the ICC. ICC reversed because the P.U.C. ignored the railroad's revenue requirements and disallowed rates at 177 percent and 180 percent of variable cost. (The P.U.C. also applied the ton/ton-mile method which the ICC had discontinued using, although it had not yet prescribed another standard.) The 6th Circuit reversed the ICC.

While the first case was pending, Kentucky Utilities filed another complaint with the Kentucky P.U.C. covering a different Seaboard coal move. The P.U.C. held for the utility and the railroad sought ICC review. (ICC #39071) the ICC reversed, on essentially the same grounds, and ordered the rate reinstated. Upon the 6th circuit opinion in the first case, the second case was reopened and reparations ordered in both.

CONRAIL

Chinanga Steel v. *P.C.&Y. R.R.* (ICC #40068)

A complaint was filed by the steel company in December 1985. It involves a joint move of less than 2 miles by the steel companies' own carrier and the P.C.&Y. R.R. (owned by Conrail and P&LE), the allegation being that the P.C.&Y. rate is too high. The relief sought is a rate decrease or a grant of trackage rights. There has been no action at the ICC because the matter is being negotiated and a settlement appears likely.

Deitch Co. v. *Conrail*

This case was brought before the Pennsylvania P.U.C. in early 1981 challenging the reasonableness of a pre-Staggers intrastate rate involving scrap iron. Between the closing of the record and the issuance of a decision, the state of Pennsylvania ceded jurisdiction over rail rates to the ICC. The ICC has asked for the file but the complainant has continued to argue with the Pennsylvania P.U.C. that it should render a decision. The issue has been pending for a couple of years and the complainant has yet to move the action before the ICC.

A second complaint was brought in 1981 based on an inflation rate increase. This was filed as a protective measure and has been held in abeyance pending the outcome of the first case. (If the underlying rate is upheld, there can be no challenge to the increase).

THE CHICAGO & NORTH WESTERN

Soo v. *C&NW* (ICC #39176 (Sub-No. 2))

C&NW raised a switching rate and Soo complained. C&NW won at the ALJ and Review Board levels. The full Commission has reopened in light of Ex Parte No. 445 and offered Soo an opportunity to introduce more evidence based on the new guidelines.

THE UNION PACIFIC

Arkansas Power and Light Systems Fuels, Inc. v. *BN & MP* (ICC #39082)

A complaint was filed February 2, 1983 assailing rates from the Powder River Basin to Newark, Arkansas. The rates were in effect for only a short period before the traffic began moving under a long-term contract. An initial decision found the rate reasonable. The Commission has reopened to consider under the new guidelines. Reparation for the brief period of the tariff moves is at issue.

Southwest Railroad Car Parts v. *M.P.* (ICC #40073)

The case involves the rate to be charged for moving empty cars. The complaint was filed December 12, 1985. The evidentiary phase will be completed April 9, 1986.

Three other cases reported by the UP were in fact section 229 cases but were not designated as such by the ICC. They were:

Martin Marietta Aluminum Inc. v. *ATSF et al.* (ICC #37597) and a companion case. *Kaiser Aluminum* v. *ATSF et al.* (#37598), filed January 5, 1981. Both involved pre-Staggers rates. The ALJ found market dominance but held the rates to be reasonable. Both sides appealed. The cases were reopened but voluntarily dismissed in September and July, 1983, respectively.

Consolidated Papers, Inc. v. *C&NW, et al.* (ICC #37626)

A complaint assailing rates on woodchips was filed February 27, 1981. The ALJ found the rates reasonable in a decision of May 6, 1982. The review board affirmed but, on appeal to the 7th Circuit, the decision was remanded for a failure to articulate a standard of maximum reasonableness. On June 3, 1985, the ICC reopened but placed in abeyance pending issuance of the coal rate guidelines. Complainants have objected to the use of the coal rate guidelines and the ICC has not yet issued a procedural order for progressing the case.

THE BURLINGTON NORTHERN

Of the 8 cases reported by BN, five have become moot by virtue of contracts and only 3 are active (and in 2 of those contracts have been entered into as to future moves).

Western Farmers v. *BN* (ICC #38738) which involves a coal rate is in the discovery stage.

Omaha Public Power District v. *BN* (#38783) involves coal, and an unfavorable ALJ decision has been appealed by BN. All future moves are under contract so the issue is limited to reparations for past moves.

Arkansas Power and Light v. *BN* (ICC #39668) involves coal and is awaiting an ALJ decision. All current moves are under contract so the issue is reparation for past moves.

The five cases now moot are:

Southwestern Electric Power Co. v. *BN* (ICC #38722) (coal)
Utility Fuel Inc. v. *BN* (ICC #39002) (coal)
Kansas Power & Light v. *BN* (ICC #39386) (coal)
Platte River v. *BN* (ICC #39687) (coal)
P.S. of Oklahoma v. *BN* (ICC #39797) (coal)

Senator **Packwood**. Now, let us conclude today with Mr. Branko Terzic, commissioner of the Wisconsin Public Service Commission, representing the National Association of Regulatory Utility Commissioners.

STATEMENT OF BRANKO TERZIC, COMMISSIONER, WISCONSIN PUBLIC SERVICE COMMISSION, ON BEHALF OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, ACCOMPANIED BY DR. WESLEY LONG, DISTRICT OF COLUMBIA PUBLIC SERVICE COMMISSIONER; AND CHUCK GRAY, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS

Mr. TERZIC. Thank you, Mr. Chairman.

Senator Long, it is an honor for me to be here to address you today. I am Commissioner Branko Terzic. I am a commissioner on the Wisconsin Public Service Commission. I am completing the fifth year of a 6-year term. I am a Republican.

With me today is Dr. Wesley Long, commissioner of the District of Columbia Public Service Commission, and Mr. Chuck Gray, of the staff of the National Association of Regulatory Utility Commissioners.

If I might for a moment, there was a comment earlier—I want to particularly say it is an honor to be here with Senator Long. I am an immigrant. I came as a child, and we did not see the Statue of Liberty. We landed in New Orleans as refugees, and so I first set foot in Louisiana. I think fondly of the State and, of course, of this country for allowing us to come in.

In our role as commissioners, the National Association members regulate; intrastate railroad operations, electric, gas, telephone, water, sewer, and other specialized "utilities" defined State by State.

We have two interests. No. 1, we regulate the electric utilities in the manner that was testified to by the earlier witness as president of an electric company, not in the manner that was alluded to by the railroads. You heard many numbers which were apples and oranges comparisons, that is, the returns of the railroads based on deflated costs and on different rate bases than the regulated returns of utilities.

Basically, what we are asking for is that those numbers be compared on the same basis; that the regulated monopoly portion of the railroads, just the captive shippers portion, be calculated on numbers that make some sense to those of us who as, the ICC Commissioners, are the policemen on the beat protecting the consumers from monopolistic practices.

The average prices you heard on coal transport were the averages for both the captive and the noncaptive shippers. In Wisconsin, we have captive and noncaptive electric utilities shippers. The noncaptives have not complained to me, to our commission. They are not leading the charge, and I think competition has served them well and shall serve them well.

We regulators, Republicans and Democrats alike, do not believe in regulation for its own sake. We are currently dealing with competitive industries; for example, telephone long distance services. We are currently dealing with competition in natural gas transportation rules recently established. We have dealt in competition in local bus service, and so forth.

We have experience in that when we have competition, we do not want to regulate. The public does not want us to regulate. However, it does not make sense to deregulate when we still have a monopoly. In that case, we have to protect the public as the ICC is supposed to do, as the original Staggers Act intended.

The Staggers Act appears to be a good one overall for the industry. We are only talking about some remedial legislation for those narrow portions that are still monopolistic. It is those customers we want to protect in Wisconsin. It is our ratepayers. In your States, it is your constituents. In our State, it is the people whose beat I am "policing," and in fact I have serious concerns when utilities do not complain to other agencies which affect their costs, as in this case.

We have, for example, ordered utilities to intervene at the Federal Energy Commission because we thought they were not fighting enough over the price of gas. We encourage this, and should we find our Wisconsin utilities who are captive shippers not being in CURE and not trying to do something where they have the mechanism, the quasi-judicial mechanism, we would be very upset. We would either order them to do it, or we would throw their costs out and let their stockholders pay for that. That is specifically my concern. I am not going to repeat my written testimony.

We are looking for protection against unreasonable rates for captive shippers, period. We think that can be accomplished by changing some of the the practices that the ICC currently has which are not good regulatory practices. They are practices which were discarded by every State commission I know of, over the last 50 years.

Reproduction costs, replacement costs, stand alone costs—I started my career, I spent 13 years as a valuation and appraisal engineer and a cost-of-service expert and witness, these have been discarded. Fair value type rate bases has been discarded in practice by every state commission I have practiced, in 20 States. You do not need them. Wall Street does not need them.

We regulate electric utilities in Wisconsin on an original cost rate base. We give them the actual debt cost. We give them a return on equity. The result has been that in Wisconsin, Wisconsin electric companies are all AAA bond-rated. Wisconsin electric utilities stocks are selling at premiums above book value. Wall Street feels very good about the Wisconsin Commission and the way in which we regulate, and we do it with a simple, original cost methodology that we have asked to be put in these amendments.

There methodologies do not hurt the utilities. Wall Street is very happy with our utilities. The stockholders are very happy. Let us consider, a 10-percent return on the total railroad capital, which was the only number on a comparable basis that the gentleman from the railroad gave.

If their (a railroad) capital structure is anything like an investor-owned utility, would be about a 15- or 16-percent return on equity. That is a lot more than 10 percent. The only thing that the owner buys, is the equity, and that is a very good return. It is a lot higher than passbook savings or whatever he was talking about.

Second, our customers do not get to pay their bills in deflated dollars. This 0.5 percent return, this 0.4 percent return, those are calculated deflated figures. Your constituents pay their bill when it comes in at the nominal number that it comes in at, and they are not very happy when Branko tells them, well, sure it was a 100-

percent increase or an 80-percent increase, but adjusted for inflation it was only 20 percent.

They say, commissioner, I have been working at this company. I have been doing wage give-backs. I have got to pay that bill the way it is rendered in the numbers that are rendered in it. Yes, the economists can fantasize about deflated dollars, but I have got to pay the bill when it arrives. The electric utility has got to pay the bill when it arrives in the dollar amounts that are there.

Dealing with deflated and reflated dollars gets you in a whole fantasy land, which is interesting for theoreticians but not very helpful for the average citizen who has to pay his bill to the utility and for the utility that has to pay its bill to the railroad.

We have a further concern I wish to address, and that is that some of the States have retained or attempted to retain the authority to regulate intrastate rail matters. In every one of the utilities that I mentioned to you, electric, telephone, gas, whatever, we have joint regulatory authority with Federal commissions.

The joint authority works relatively well. There are some problems, however. In those totally local areas of concern we have the expertise. We have local staff. We have the hearing capability. We can handle that job. We can do it well. The citizens know where we are. They call us and they can get hold of us.

We are looking in this bill to return some of that Federal preemption that is in the Staggers Act back to the state agencies where it would be under this scenario. The ICC would establish under the law what the requirements are. The state would exercise it. On appeal to the ICC, the ICC would have the opportunity to review it.

That is my testimony. I would be very happy to answer any questions about what commissioners do and how we regulate, why we are concerned, or esoteric questions such as how cost indexes are made, why costs indexes are bad. I have unique experience in that I developed a cost index for the independent telephone industry in 1976. The cost indexes are terrible things if they are misused, and obviously this one is misused if it never goes down.

Thank you.

Senator Packwood. Up until a few years ago in the telephone industry, as we all know we used long-distance rates to subsidize residential rates. We are moving away from that, slowly now but moving away from it. Do you agree with that?

Mr. Terzic. Yes, I do. In Wisconsin we are right on top of that trend. We have documentary evidence that in the 1940's and 1950's in the minutes of the meetings of the Federal Communications Commission they made public rational statements that they would not lower long distance rates when they knew the costs were going down because they did not want to raise——

Senator Packwood. It was a conscious policy.

Mr. Terzic. Absolutely.

Senator Packwood. Is there any possibility that some of that exists now in the railroads hauling coal where they have a captive market? They do not mind the rates being higher than costs, and they are using part of that to subsidize their costs in competitive areas?

Mr. TERZIC. Absolutely likely. That is why I believe Staggers wisely directs the ICC to investigate that. Absolutely.

Senator PACKWOOD. Yet, the overall return of the railroads is not that great.

Mr. TERZIC. It is terrific if those numbers that were given were cast the way Wall Street would cast them. What does Wall Street say about how the utilities are doing? What has their stock price done? I do not buy the argument when you have a railroad holding company, where 80 and 90 percent of its revenue comes from the railroad portion of the operation, that we cannot look at what Wall Street is saying about that company.

Senator PACKWOOD. Absolutely. I am not arguing that. All I am saying is that overall the railroad companies are not as good an investment as a number of others, or has not been over the years and maybe they are going to get better.

Now, if we were to move to cost-based rates on captive traffic, will that cause their returns to go down, or somehow will they be able to increase their charges on noncaptive traffic?

Mr. TERZIC. Competition will force prices where competition will force prices. It is sort of ingeneous to make up the difference on captive customers. If that happens it means the railroads are not viable the way they are operated, with the wages they have to pay, with the way they are organized, and it will continue.

Other industries are going through that catharsis, and so is the railroad industry unless we want to make it public policy that we shall subsidize the railroads through certain mechanisms. I might prefer to do it through the tax mechanisms or through other mechanisms. That is, if they cannot make it on the general economy, given the accounting and tax system we have, then let us change their accounting and tax system.

Senator PACKWOOD. Do you want to subsidize those who use them where there are competitive rates at the expense of having the captive rates be higher?

Mr. TERZIC. Do I want to? No.

Senator PACKWOOD. No, I think that is the question.

Mr. TERZIC. Absolutely.

Senator PACKWOOD. You are subsidizing once you bear the expense of another shipper.

Mr. TERZIC. Absolutely.

Senator PACKWOOD. Senator Long.

Senator LONG. Our Nation has public service commissions who have a rather long history, and I think in most cases a very distinguished history, of protecting consumers against abuses of monopoly power.

What is your association's opinion of the ICC's record of protecting consumers of rail services against abuses of monopoly power?

Mr. TERZIC. Once again, our specific concerns are in the captive area. We have specific information for those companies that are hurt. It does not help to say on the average everyone is doing OK. If I get one complaint from a ratepayer who says the individual bill to him is wrong, is miscalculated, I am obligated to act on it.

Wisconsin Power & Light has a very unique situation. They have three powerplants that are captive, and three powerplants that are noncaptive. Over the last 5 years for the captive powerplants in real dollars, the ones that they make a check out for, the increase in freight rates over the 5 years, 1979 to 1984, has been 106 percent, 74 percent and 78 percent on the three powerplants which are competitive they tell me. These numbers better be good, because I will take it out of their hide if they are not.

They tell me that on the noncaptive plants in the same State the rate increases in freight have been 16 percent, 6 percent and 21 percent. Now, those are not average figures. These are actual figures. These customers, the 500,000 Wisconsin Power & Light customers, are the ones I am here to protect and the ones that this utility is worried about. That is a fact.

Now, that may be the only utility in the country that has that problem, but the Staggers Act says this utility will be treated in a special manner, this customer, and that is all we are asking for. We think remedial legislation does that.

Senator LONG. Do you know of any commission other than the ICC that allows a monopolist to unilaterally set monopoly rates or force the consumer to bear all of the burden for proving that the monopoly rate is to high?

Mr. TERZIC. I do not. I have worked in about 20 States, and I am not familiar with a State that does that.

Senator LONG. Does any public service commission use stand alone costs as a test for reasonableness of monopoly power?

Mr. TERZIC. No, not as a test of reasonableness for monopoly power. Stand alone costs, and I have calculated them, have been used in competitive areas I do not know of any place where they have been used alone. When they have been used, they have been the absolute highest outside boundary because, on the other end, the theoretical construct is "You build a system only for you, and what will that cost?"

The opposite end is: "We built the system for the competitive market." What is the incremental cost of building it for the one captive customer? That is a very, very low number, and so the two extremes of numbers are "stand alone," very high and "incremental," very low, the cost of serving you once you build the system to serve competition. The reality is that the systems were not built that way. They are hypothetical constructs. They do not make sense in practice.

Senator LONG. Do public service commissions allow utilities to include deferred taxes in the rate base?

Mr. TERZIC. No, the rate bases are calculated differently State by State. Overall, no, that is cost-free capital. The return was not provided. The investor did not provide it, and the bondholder did not provide it. The Government provided it, and we treat it that way.

Senator LONG. In a situation where rates are very high, as interest rates have been recently, do they allow the utilities to use a current cost of debt rather than what they are actually paying in debt for the money that the company has borrowed over many years?

Mr. TERZIC. I am not aware of any that do. If they do, they make other adjustments which compensate. For example, you might adjust your depreciation, keeping in mind that in all of these techniques no customer pays the "cost of capital," directly. No customer makes out a check for that and a separate check for the fuel cost and a separate check for wages. The customers pay a total bill.

If there is a State that does that, it makes other accounting or policy accommodations that go in the other direction.

Senator Long. Would you give me your judgment of the revenue adequacy test used by the ICC and perhaps compare it to the revenue adequacy test that your commission or other commissions generally would use?

Mr. Terzic. In the first place, none of the commissions I know of go through the convolutions of restating things in reproduction and replacement cost rate bases. Even though states still have statutory language, like Illinois, I believe, still has or had statutory language that said they must do reproduction costs. They tell the utilities not to file it. So we do not calculate rates it on that basis.

Our standards are generally these. We have court decisions; as a matter of fact, many of the same decisions, Supreme Court decisions, that affect the ICC.

The standards generally are the financial standards. Almost no commission in reality even regulates on rate base anymore. We generally return-on-equity regulate, because it is that number that the stockholders will see, and that is the person who is going to buy the stock. They will also look at the bond ratings, and so if you look at what Wall Street says the return on equity ought to be, the way Wall Street calculates it, not the way every other industry calculates it, we will generally look at the actual debt incurred.

I want citizens to pay for the money that was borrowed to the people who borrowed it. The pensions funds, private investors who buy bonds should be given the money for those bonds through utility rates, and it flows through dollar per dollar with some minor adjustments so we do those things separately.

For financial health, we look at the stock price. We compare it to other industries. This is not simple. We do not do it overnight. We do not do it capriciously. It requires a lot of data, and yet we think that our techniques are applicable. There are techniques available to the ICC, and we welcome their use of them.

Senator Long. Thank you very much.

Mr. Chairman, thank you.

Senator Packwood. I have no further questions. You were a very good witness, Mr. Terzic. I appreciate your coming.

Mr. Terzic. Thank you. It is a real honor to be here.

Senator Packwood. Thank you, sir.

[The statement follows:]

Statement of the National Association of Regulatory Utility Commissioners

Mr. Chairman and Distinguished Members of the Subcommittee: My name is Branko Terzic and I am a commissioner with the Wisconsin Public Service Commission. I am testifying today on behalf of the National Association of Regulatory Utility Commissioners, commonly referred to as the "NARUC". Accompanying me today from the NARUC are Karen L. Hochstein, Director of Congressional Relations and Phyllis B. Levine, Assistant Director of Congressional Relations.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within our membership are the governmental agencies of the fifty States and the District of Columbia, Puerto Rico and the Virgin Islands engaged in the regulation of utilities and carriers. Our chief objective is to serve the public interest by seeking to improve the quality and effectiveness of government regulation.

The members of the NARUC greatly appreciate your invitation to address the Subcommittee on the Consumer Rail Equity Act. Since many of our members regulate electric utilities, we are deeply concerned with the prices electric utilities pay to transport domestic coal, as these prices are directly passed on to the ratepayers. To that end, the NARUC supports S. 477, the Consumer Rail Equity Act, which would clarify the intent of Congress regarding the Staggers Rail Act of 1980. This bill 1) would constrain the Interstate Commerce Commission (ICC) from using unorthodox regulatory practices to increase rail earnings above reasonable levels, and 2) would provide rail shippers access to rail service that is competitive and priced fairly and reasonably.

Our statement will address two issues. The first is the protection against unreasonable rates for captive shippers, and the second is our opposition to Federal preemption of State authority to regulate instrastate rail matters.

PROTECTION AGAINST UNREASONABLE RATES FOR CAPTIVE COAL SHIPPERS

Captive coal shippers are in need of adequate protection against unreasonable transportation rates. Coal is the primary fuel for more than half of this country's electric generation. On a national average, transportation costs account for approximately one-third of the delivered price of coal shipped by rail. Moreover, there are almost no practical alternative or competing transportation modes, whether slurry pipelines, barges or trucks, to ship coal to end users. The result is that for half of the coal that utilities transport, they are captive customers of rail services.

A major factor in increasing the price of coal transport for captive shippers is the ICC, whose startling regulatory interpretation of the Staggers Act has provided little protection for captive shippers. In addition, the ICC refuses to regulate rail transportation rates using standards which have any relation to the costs of providing service. A comparison of the ratemaking standards employed by the ICC concerning monopoly rail rates with comparable utility standards highlights the ICC's failure to adequately protect captive rail shippers.

A. Determination of revenue needs

In determining the total revenues to be collected from electric utility ratepayers, State regulatory commissions calculate a utility's "revenue requirement". This total is derived by summing the utility's cost of service (labor, fuel, depreciation, materials, administrative expenses, etc) and its return on capital (return on depreciated rate base sufficient to provide a reasonable profit to invested capital). Similarly, the ICC calculates the level of total revenues adequate to cover a railroad's annual costs plus a return on the capital invested in its plant and equipment. In both cases, this calculation is crucially important because it determines the systemwide rate levels which the regulated entity may charge. In the following areas, the ICC has chosen to use accounting and regulatory standards far more favorable to rail investors than State commissions would permit.

In determining utility rate base, State commissions use the original cost of investment. The ICC calculates the rail "investment base" based on current or replacement costs. In an inflationary economy replacement costs are higher than actual historic costs, and therefore rail rate levels will be increased.

In calculating a utility's cost of capital, State commissions use the actual cost (interest rates) of embedded debt. Although the costs of embedded debt are readily determinable, the ICC calculates the cost of rail debt on the basis of current bond and interest rates, again overstating actual costs.

In determining the overall cost of rail capital, the ICC assumes a debt-equity ratio of 37:63, while most utility calculations fall in the range of 50:50. Since equity is more expensive than debt, the ICC's ratio serves to increase rail revenue needs.

By the ICC's calculations, no Class I railroad, regardless of its profitability, its bond ratings, or the level of its retained earnings, earns adequate revenues. In the wake of the proposed sale of Conrail to Norfolk Southern Railroad, it is nonsensical that the ICC has determined Norfolk Southern to be revenue inadequate, when the Department of Transportation and the Senate have sanctioned the sale for $1.2 billion. A legislative remedy must be implemented to correct this disparity.

B. Stand-alone costs

Once a utility's or railroad's revenue needs are determined, regulators must design rates to allocate those needed revenues among the consumers of the monopoly's services. Under law, no individual utility ratepayer or (in theory) rail shipper should be charged rates exceeding a reasonable maximum. The ICC has determined that monopoly rail rates are not unreasonable as long as they do not exceed the "stand alone costs" of providing rail service to an individual shipper or group of shippers. Ex parte No. 347 (Sub No. 1) served September 3, 1985.

The concept of stand-alone costs (which is totally foreign to any system of electric utility regulation) means, in essence, that no rail rate is too high if it is less than the costs of serving an individual shipper or group of shippers as if these shippers were isolated from other rail consumers. In its purest form, this would mean that a railroad can charge a utility any rate it wants as long as that rate is less than it would cost the utility (on a per ton basis) to construct a brand new railroad to serve its generating plant, including the cost of right-of-way, track, bridges and other structures, equipment and the like. The concept of stand-alone rail costs is functionally equivalent to a State commission allowing a utility to raise its rates to a homeowner until the rates reached a per kwh level at which the homeowner would construct his or her own generating capacity.

Therefore, the NARUC supports legislation that directs the ICC, within twelve months of enactment, to adopt a new rate reasonableness test that is not the stand-alone cost test. The new test must consider, among other factors, the railroad's need for revenues, the relationship of the rate to the railroad's cost of providing the service, and whether and to what extent the railroad's revenue needs require captive shippers to pay rates that exceed the jurisdictional threshold.

C. Other concerns

Other areas that are of concern to State regulators are the burden of proof and the misguided notion that if rail rates decrease electric utility profits will increase.

In proceedings before the State regulatory commissions, electric utilities bear the burden of proving that any change in rates is just and reasonable. Before the ICC, shippers bear the burden of proving that rates challenged as being too high are unreasonable. This allocation of the burden of proof is important because the ICC has made it difficult for shippers to obtain from the railroads the information necessary to challenge unreasonable rates and practices. Therefore, it is virtually impossible for a shipper to successfully challenge a rate or practice. This requires a legislative remedy unlike other areas which involve ICC interpretations.

The burden of proof is also an issue in the ICC's test for market dominance. The NARUC supports Section 3 of S. 477 which would codify and clarify the ICC's July 31, 1985 market dominance test. Under this test, the shipper must prove that it has no transportation alternatives, but the railroad could allege and prove that the shipper has a product or geographical alternative. Product and geographic competition will not be considered in determining captivity at the origin.

In the debate surrounding the coal transportation issue, certain rail interests have suggested that legislation which serves to lower coal transportation rates would increase utility profits. This argument against legislative action assumes that State commissions will permit utilities to retain the amount of decreased transportation changes. This assertion is false. In every jurisdiction, annual rail transportation charges are recovered dollar-for-dollar from utility ratepayers as an expense item, in some cases through a fuel adjustment clause. Transportation costs are not a rate base item upon which a utility earns its profit. If rail rates increase by $200 million in a given year, total electric bills increase by that amount. If rates decrease, electric bills are lowered by the same amount. If reflected in a fuel adjustment clause, transportation cost changes are adjusted automatically in consumer bills. Therefore, electric utility will "profit" by lowering its transportation costs.

D. Conclusion

The ICC has adopted or proposed a program of policies and procedures to regulate monopoly rail service which no State regulatory commission would employ to regulate the rates of monopoly electric utilities. The ICC's policies have brought the country to the point where no railroad earns adequate revenues and no rail rates are unreasonably high. To correct these unbalanced policies and to provide protection for electric utility ratepayers who bear the costs of excessive coal rates, the National Association of Regulatory Utility Commissioners, as indicated in Appendix A in a resolution adopted on March 1, 1984, supports legislative initiatives to address this situation. Specifically, we urge the Congress to enact legislation which obtains adequate protections and access to competitive rail service for captive rail shippers and which obtains for consumers fair and reasonable regulation which protects them from exploitation.

The Consumer Rail Equity Act, S. 477, is the ideal legislation to combat this problem. The bill clarifies the intent of Congress regarding the Staggers Rail Act of 1980 by constraining the ICC from using aberrant regulatory practices and would provide rail shippers access to rail service that is competitive and priced fairly and reasonably. We respectfully urge the members of the Subcommittee to support S. 477 to curb the rail pricing abuses sanctioned by the ICC.

II. FEDERAL PREEMPTION OF STATE AUTHORITY TO REGULATE INTRASTATE RAIL MATTERS

A. State certification requirement

The NARUC is strongly opposed to unwarranted Federal preemption of State authority to regulate intrastate rail matters. It is our belief that the public interest is best served when decisions materially affecting the quality of citizens 'lives are made by officials who are easily accessible to those citizens. Therefore, the NARUC strongly advocates repeal of the State certification requirement contained in the Staggers Rail Act of 1980, 49 U.S.C. Sec. 11501 (B) while leaving the ICC free to engage in appellate review of State intrastate ratemaking decisions under 49 U.S.C. Sec. 1101 (C) as revised.

Section 214 of the Act requires each State regulatory commission wishing to exercise jurisdiction over intrastate rail rates to be certified by the ICC. Following enactment of the Staggers Act, forty States immediately filed requests to be certified, and it took five years from enactment of the Act for the ICC to grant the majority of the States permanent certification.

The certification requirement contained in Section 214 of the Staggers Act is seriously flawed due to the absence of any federal guidelines to facilitate the development of reasonable and clearly articulated certification standards by the ICC. The absence of any clear standards in the Act resulted in inordinately lengthy proceedings to implement the act and in the ICC's questionable interpretation of the Act to require that State standards and procedures "mirror" the ICC's ratemaking rules.

The absence of any formal standards in the Staggers Act deprives State regulatory agencies of guidelines for use while developing their submission for certification to the ICC, leaving the extent to which the States have permissible discretion to regulate intrastate rates decidedly unclear. Moreover, the absence of formal standards has enabled the ICC to abuse the certification requirement.

The certification requirement contained in Section 214 of the Staggers Act has failed to further the Congressional intent underlying the Staggers Act. Instead, it has resulted in an extremely burdensome, unduly preemptive, and widely criticized review process by the ICC. Clearly, the present certification process, lacking any clear federal guidelines and never properly implemented, has no practical application. Therefore, the certification requirement should be repealed.

The States have played an historic role in regulating rail rates. The intrastate traffic patterns in each State are unique and each State should be permitted to continue to regulate rates in this area. By encouraging meaningful State consideration of intrastate rate cases, consumers and small shippers will be assured an opportunity to be heard in a local forum best situated to determine the uniquely local needs of both carriers and shippers.

Moreover, certification fails to effectuate the Congressional purpose to preserve the State role in promoting federally conforming intrastate rail rate regulation. If repealed, friction between the ICC and the States could be reduced dramatically while preserving fundamental principles of federalism. In addition, States would be free to develop innovating procedures and standards for intrastate rail rate regulation consistent with federal requirements from which the ICC and the nation as a whole could benefit.

B. Standard of review

The NARUC is also concerned with the standard of review employed by the ICC for review of State rail rate decisions under 49 U.S.C. Sec. 11501 (C). Under well-established principles of administrative law, the standard of review applicable to agency proceedings, unless clearly articulated by statute, is limited to the appellate function, where deference is granted to agency expertise. Here, although the ICC possesses expertise regarding the regulation of rail rates, each State authority possesses unique expertise as to the intrastate traffic patterns of the particular State. Therefore, we believe that the ICC should apply to its review of State rail rate regulation the deferential standard of review applicable to appellate review of ICC decisions. Unless Congress wants wholesale preemption of the State role in regulating intrastate rail rates, it should limit ICC review of State intrastate rail rate decisions to the appellate function.

Accordingly, the ICC should be bound by the State agency's factual decisions as long as there is substantial evidence in the record. State conclusions of law regarding the application of federal standards to the facts should be upheld unless clearly erroneous. State procedural decision-making should be upheld unless arbitrary and capricious. Thus, the ICC should restrict its scope of review to that set forth in the Administrative Procedure Act, 5 U.S.C. 706.

C. Conclusion

Attached in Appendix B is recommended legislative language reflecting our proposed amendments to the Staggers Act. Thus, a State authority would be able to exercise jurisdiction over intrastate rail matters without prior certification by the ICC. In addition, the ICC would be required to review a decision of a State authority upon petition of a party to its proceeding for conformity with federal law. Within 120 days after receipt of a petition, the ICC would be required to engage in appellate review of the matter as provided for under 5 U.S.C. 706 of the Administrative Procedure Act, remanding the matter to the State agency if inconsistent with federal law.

APPENDIX A

RESOLUTION

To Provide Reasonable Rates for Captive Railroad Traffic Under Standards Consistent with and Similar to Those Generally Applied by State Regulatory Commissions

AND

To Provide Shippers Access and Use of a Railroad's Facilities

Whereas, the Staggers Rail Act of 1980 provided for the deregulation of competitive rail traffic and directed the Interstate Commerce Commission to continue to maintain reasonable rates where there is an absence of effective competition for rail traffic within the Commission's jurisdiction; and

Whereas, over half of the electric energy in the United States is generated using coal, the majority of which is transported to electric utilities under non-competitive conditions by one railroad and subject to the jurisdiction of the Interstate Commerce Commission; and

Whereas, the Interstate Commerce Commission has issued a series of decisions effectively withdrawing regulation over the pricing of this captive rail traffic, including decisions which: (1) define "market dominance" so as to place ICC regulatory protection beyond the reach of many captive coal shippers; (2) set standards for "reasonable" rates which have no relation to the cost of providing service and which will allow coal transportation rates to double in real terms in five years; (3) exempt export coal from regulation although United States coal is already fifteen to twenty percent more costly than world market prices due in large part to transportation costs; (4) define "revenue adequacy," on which several pricing freedoms for railroads under the Staggers Act was based, unrealistically, so that no Class I railroads, no matter how profitable, are considered to have adequate revenues, and highly profitable railroads will be allowed billions of dollars in extra rate increases; and

Whereas, customers of electric utilities will, unnecessarily, incur much higher electricity rates as a result of these ICC determinations; and

Whereas, over the repeated objections of NARUC and individual State commissions, the Interstate Commerce Commission has usurped State authority to regulate intrastate railroad movements consistent with the Staggers Act; and

Whereas, the railroad industry, consumers and the captive shippers that serve them would benefit from (1) the restoration of competition to rail service areas now served by only one railroad and (2) the assurance that fair and reasonable freight rates are charged; now, therefore, be it

Resolved, That the National Association of Regulatory Utility Commissioners assembled at Washington, D.C. on March 1, 1984 urges Congress to enact legislation,

First to ensure reasonable rail rates for captive rail traffic, including provisions which:

1. Define "market dominance" in the context of effective competition for the transportation to which the rate applies, so that all captive shippers may obtain ICC regulatory review;

2. Require consideration, in determining "adequate revenues" for railroads, of several realistic indicators of financial health, and require:

a. the use of embedded cost of debt,

b. standard original cost depreciation accounting,

c. other measures commonly applied by regulators in calculating the railroad's return on investment, and

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d. when appropriate, consider equity and debt costs to the holding company and look at the reasonableness of the transfer price between affiliates;

3. Require ICC consideration, in setting maximum reasonable rates, of the following standards:

a. the cost to the railroad of providing the service involved;

b. whether the traffic involved is paying an unreasonable share of the railroad's fixed costs;

c. the impact of the rate on national energy goals;

d. the extent to which railroad revenue shortfalls are attributable to hauling traffic at noncompensatory rate levels or failing to maximize earnings on competitive traffic; and

e. price stability and impact on shippers;

4. Require the ICC to calculate the inflation index (as set forth in the Interstate Commerce Act) upon which automatic rate increases are based on the basis of actual, not imputed, increases in costs; as well as allowances for productivity gains; and to require rail rates which have increased automatically with that inflation index to decrease when decreases in railroad costs lower that index;

5. Reauthorize and fund the Railroad Accounting Principles Board;

6. Require adoption of fair and reasonable procedures for ICC review of State regulatory decisions on intrastate rail rates;

7. Prevent anticompetitive or predatory cancellations of joint rates;

8. Prohibit the Interstate Commerce commission from exempting market dominant traffic from regulation; and

9. Prohibit the use of confidential pricing in shipping contracts, but in contrast make available all information necessary to ensure enforcement of (Long-Cannon) Congressional intent against cross subsidy; and

Second to require:

a. rail carriers to permit, with reasonable compensation, access and usage of facilities to shippers for whom the sole means of connecting with the trackage of another rail carrier or of reaching the destination of a shipment is over the railroad's facility; and

b. a review of line abandonment procedures to ensure against abandonment of rail service due to the operational preferences and/or strategic planning of the rail companies; be it further

Resolved, that the National Association of Regulatory Utility Commissioners supports legislative initiatives to address these critical issues, and urges the Congress to enact legislation to obtain for captive rail shippers

1. protection from the practices outlined above, and

2. access to competitive rail service and to obtain for consumers fair and reasonable regulation which protects them from exploitation.

APPENDIX B

RECOMMENDED LEGISLATIVE LANGUAGE TO THE STAGGERS RAIL ACT OF 1980

Section 11501(b) of Title 49, United States Code, amended to read as follows:

"(b)(1) A State authority exercising jurisdiction over intrastate transportation provided by a rail carrier which also provides transportation subject to the jurisdiction of the Commission under subchapter I of chapter 105 of this title shall do so consistently with the provisions of this subtitle.

(2) Any decision of a State authority exercising jurisdiction over intrastate rates, classifications, rules, and practices for intrastate transportation described in paragraph (1) of this subsection, upon petition of a party to its proceeding, shall be reviewed by the Commission to determine whether the State authority has entered a decision consistent with the provisions of this subtitle.

Section 11501(c) of Title 49, United States Code is amended as follows:

(c) Within 120 days after the receipt of a petition under paragraph (b)(2) of this section, the Commission shall take final action on any such petition, applying the same scope of review as that of a reviewing court as set forth in 5 U.S.C. 706 for review of a decision of an administrative agency. If the Commission determines that the State authority's decision is inconsistent with the provisions of this subtitle, it may vacate the decision of the State authority and shall remand the matter with appropriate instructions.

[The following information was subsequently received for the record:]

Questions of Senator Hollings and the Answers

Question 1. You indicate that rail revenue adequacy should be determined based on the same computations applicable in determining electric utility revenue adequacy. What are the specific revenue adequacy standards applied to the utilities by the State commissions? Are they the same in every State? What is the logic behind these standards?

Answer. (a) The basic formula for revenue adequacy applied to electric utilities by State commissions is:

Reasonable Operating and Maintenance Expense plus Depreciation based on Original Cost plus Taxes plus Return on Investment equals Total Revenue Requirement.

Debt plus Preferred plus Common Equity equals Return on Investment.

The State commissions and the Interstate Commerce Commission (ICC) interpret the components of the above equation differently resulting in very diverse conclusions as to railroad revenue adequacy. The conceptual differences in methodologies are as follows: (1) The States use historical original cost investment base valuation and depreciation accounting, while the ICC applies an alternative method of accounting, unique to the railroad industry; (2) The States exclude deferred taxes from the investment base or consider them as funds obtained at zero cost of capital resulting in no authorized return on the deferred tax amount. The ICC includes these funds in the investment base even though they are acquired at no cost: (3) In calculating the cost of capital the States consider: the contractual cost of debt, as opposed to the current cost; the actual book value of debt and equity, as opposed to a relationship based on market value; and the actual cost of preferred stock, as opposed to including it in common equity.

(b) Most of the State commissions use some form of original cost investment base valuation. (See Appendix). In the States where fair value or prudent investment is used it is usually interpreted as depreciated original cost investment.

(c) The logic behind the State methodology is as follows: (1) Using historical cost investment base valuation is preferred because it can be audited, as it represents actual expenditures and recognizes cost of plant as acquired. Replacement cost must, by definition, be a theoretical figure, and calculation of which has been subject to great debate, controversy and professional difference of opinion. (2) Deferred taxes represent an interest free loan from the Federal Treasury to the electric utilities, therefore it currently represents zero cost of capital and logically should not be included in the rate base and passed on to ratepayers; (3) The States' method of calculating cost of capital by using the imbedded cost of debt is logical because it provides the utility with a rate of return which directly corresponds to the actual cost of capital incurred by the utility. The States calculate the return on equity (to stockholders) based on market conditions.

Question 2. You have testified to a concern about escalating coal rates which result in higher utility rates. In evaluating utility rates filed with the State commissions, do you know what percentage of those rates represents transportation cost? Can you present specific evidence that this cost was escalated?

Answer. (a) The total delivered cost of coal is passed on directly to a utility's ratepayers and generates no profit or return for the utilities themselves. While rail transportation represents on average 35% of the delivered price of coal, the impact on each utility varies with the mix of coal and other products used to produce electricity.

(b) According to the U.S. Department of Energy's Energy Information Administration the average cost of transporting coal has risen from $3.67 per ton in 1972 to $12.09 per ton in 1983.[1] Since the enactment of the Staggers Act the average delivery price has leveled off. However, the regulatory climate has perpetuated rates that were already deemed excessive. The inequity of coal transportation prices can be seen by looking at an example of a captive shipper. From 1976 to 1985, the San Antonio public utility, which was captive to Burlington Nothern, experienced an increase in coal rates from $10.93 to $27.66 per ton. This increase was directly passed on to the ratepayers. In 1985, when the Chicago and Northwestern Transportation Company was allowed to compete with Burlington Northern in that area, the bid was $19.60 per ton, a reduction of $8.06 per ton or 29%. Thus, the Consumer Rail Equity Act must be enacted to provide rail shippers access to rail service that is competitive and priced fairly, to that ratepayers will not have to bear the burden of excessive coal transportation prices.

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[1] AAR Paper *An Analysis of the Electric Utility Industry*, July 1985.

Question 3. NARUC supports the elimination of the ICC certification process established by the Staggers Act. Does this mean a return to the pre-Staggers days with respect to State regulation? Given that the certification process has involved all of the States in one way or another, what purpose is served by eliminating the process now?

Answer. (a) No. The State regulatory agencies recognize that their function under the Staggers Act in regulating intrastate rail rates is to apply Federal law, and they will continue to do so without the certification process. The ICC will still be free to engage in appellate review of State intrastate ratemaking decisions under 49 U.S.C. Sec. 11501(c) as revised. The review process, not certification, is the appropriate mechanism for bringing State rail decisions into conformity with Federal requirements.

(b) The certification process has been in effect five years and has no practical application. Why keep a process that fails to effectuate the congressional purpose of preserving the State role in promoting federally conforming intrastate rail rate regulation? It has resulted in an extremely burdensome, unduly preemptive and widely criticized review process. However, once the States all become certified, this process becomes a non-issue. Also, the ICC is currently required to recertify States after five years, so the whole process will not be eliminated.

[Whereupon, at 12:35 p.m. the meeting adjourned.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF HON. ALAN K. SIMPSON, U.S. SENATOR FROM WYOMING

I do commend the chairman, my fine friend, Senator Bob Packwood, for holding this hearing on S. 477, the Consumer Rail Equity Act. This legislation is intended to address the situation faced by captive shippers—those poor guys who have access to only one railroad and who, when they try to ship products like coal, agricultural products and trona, often find that the rail rates are extraordinarily high.

Congress passed the Staggers Rail Act in 1980 in an effort to preserve, and in some instances restore, the economic health of America's railroads. As a result of the legislation, the Interstate Commerce Commission was directed to "Balance the National Interest" between the captive shipper and the railroads. In the ensuing years, the ICC has not fulfilled this requirement.

It is now abundantly clear that Congress must act to address the monopoly pricing power exercised by some of America's railroads—power that has been misused. Examples are abundantly clear in my State of Wyoming—examples which demonstrate the need for legislation such as that which we are considering today. Wyoming coal mines have lost sales in the competitive markets due to the costs of transporting the coal from the mine mouth to the buyer. In one instance, a Texas utility company purchased its coal from a Canadian mine rather than from a mine in Wyoming. The Wyoming price at the mine mouth was much lower, but the exorbitant rail rates took the Wyoming coal out of the competitive price structure—even though the Canadian coal had to be taken by rail from the mine to the coast and then by ship down the Pacific coast through the Panama Canal and into the Gulf of Mexico and then into Texas. How absurd.

It is for reasons such as these that I am a cosponsor of S. 477, the Consumer Rail Equity Act. The time has come to restore competitive balance in the rail industry by insuring competitive rail access to facilities of otherwise "rail-captive shippers." I am pleased to lend my support for this important piece of legislation.

STATEMENT OF HON. MARK ANDREWS, U.S. SENATOR FROM NORTH DAKOTA

Mr. Chairman, Members of the Subcommittee, as one of the principal sponsors of S. 477, the Consumer Rail Equity Act, I want to commend the Chairman of the Subcommittee for holding hearings on that legislation and on the Staggers Rail Act of 1980 and its implementation by the Interstate Commerce Commission ("ICC"). By all accounts, the record of the ICC shows that it has fallen far short of the responsibilities it was delegated by Congress to provide protections for captive shippers in the face of railroad deregulation and the anticipated trend towards concentration in the railroad industry.

As the Chairman of the Senate Transportation Appropriations Subcommittee, I have had the opportunity during recent years to watch closely the activities of the ICC. With respect to captive shipper issues, as well as other matters, the Commission has done little, in my opinion, to gain credibility and support from the Congress. Apparently, the Administration has been unimpressed as well with the ICC's record as a regulatory agency and the President's fiscal year 1987 Budget recommends the elimination of funding for the ICC by October 1, 1986. While the Appropriations Committee will consider this proposal consistent with its jurisdictional responsibilities, this Subcommittee will also have the opportunity to address it if and when appropriate legislation is submitted by the Administration.

Despite the dismal record of the ICC, abolishing the Commission may not be in the best interests of captive shippers and other shippers dependent upon the railroads. There must continue to be an independent forum for resolving captive shipper complaints, as required by the Staggers Act. I would encourage the Committee to assess the provisions of the Consumer Rail Equity Act (S. 477) in the context of a possible elimination of the ICC and the continuing consolidation of the railroad industry. Abolishment of the ICC only makes the need for changes in Staggers Act more urgent. In the meantime, we must examine the recent record of the ICC in light of its implementation of the Staggers Act since 1980.

The exercise of monopoly power by American railroads is a historical problem, but today is aggravated by the continuing failures of the ICC to administer the Staggers Rail Act. When it passed the Staggers Act, Congress was fully aware of the impact of railroad monopolies and the possibility for shipper abuse by unrestrained monopoly pricing power in a deregulated environment. Thus, Congress recognized that there should be a place where captive shippers, with no transportation alternatives, could challenge excessive rail rates. Congress intended that the ICC should be the forum where captive shippers could go to seek relief from rate abuse and barriers to entry onto rail systems.

After five years, it is clear that the ICC has not and will not play the role that Congress intended. Through its procedures, its regulations and its decisions, the Commission has shown almost complete disinterest in the problems of captive shippers. The bottom line is this: under the principles it adopted to implement the Staggers Act, the ICC has yet to order any captive shipper rate to be reduced.

Mr. Chairman, under pressure from Congress and groups of captive shippers, the ICC has made several efforts to change its rules so that captive shippers might have a better opportunity to challenge unreasonable rates. These efforts have been largely unsuccessful and today captive shippers—even if they can afford prolonged and expensive proceedings at the ICC—still have little hope of securing a favorable decision.

As you recall, when the Senate Commerce Committee held two days of oversight hearings last November on the ICC's implementation of the Staggers Act, it heard statements from those who believe Congress must intervene to change the ICC's approach to captive shipper issues. This testimony came from those who are concerned with rate reasonableness as well as those who are concerned with competitive access issues like the preservation of joint rates and reciprocal switching agreements. It came from utilities and manufacturers, from midwest grain shippers and northwest timber shippers, from unions and consumer groups.

One witness expressed graphically the nature of the problem at the ICC. Dr. Mark Cooper, testifying for the Consumer Federation of America, noted that CFA participates in many regulatory proceedings at the state and Federal levels. They win some and lose some, as he testified: . . . but above all, we have a sense that the process is reasonable—that the rules are impartial and the deliberative bodies are engaged in a good faith effort to balance the needs of consumers and the providers of monopoly services. That simply is not the case with the ICC's implementation of the captive shipper provisions of the Staggers Act. The scales have been so tilted in favor of the railroads and the burden placed on complainants so onerous, that we despair of getting a fair hearing or achieving a sensible result.

Mr. Chairman, the ICC has had every opportunity to mend its ways and fulfill the mission that Congress planned for it. It has not done so. In 1984, Senator Danforth introduced a resolution which he described as giving "a clear signal to the ICC and others that we in Congress really do expect all of the goals of the Staggers Act to be met."

The resolution suggested the need for action by the ICC in four key areas: the ICC's revenue adequacy test; the ICC's market dominance test; the ICC's rate reasonableness test; and the ICC's exercise of its authority to assure competition among railroads.

What has the ICC done in the year and a half since the resolution's introduction? The ICC has changed its market dominance test as suggested in the Danforth Resolution; it has made only minor and unacceptable changes to the rate reasonableness test; it has refused to take any action on its revenue adequacy test; and it appears to have actually regressed in fulfilling its responsibility to provide "competitive access."

The net result of the Commission's actions and inactions in the past year is that captive shippers are still without protection against unreasonable rates and that the Commission still does not act to assure competition among railroads.

The Commission's stubborn refusal to change its test for judging the economic health of railroads dramatizes the need for Congressional action. The revenue adequacy test is crucial because, as long as the ICC finds a railroad to be revenue adequate, captive shippers are, under guidelines applied by inadequate, captive shippers are, under guidelines applied by the Commission, essentially precluded from any rate relief.

The major railroads in this country are enjoying a long-awaited return to financial prosperity. They are making enough money to buy pipelines, for example. Recently, the Senate approved a proposed plan to sell Conrail to the Norfolk Southern

Corporation. During the debate on that legislation, it was asserted repeatedly that Norfolk Southern was a "highly profitable" railroad with "deep pockets" that could survive any downturn in the economy during the next few years. Yet, despite these claims, the ICC, utilizing a totally unrealistic revenue adequacy test which overstates both railroad investment base and cost of capital finds that the two railroads that provide 90 percent of the revenues to Norfolk Southern are both revenue inadequate.

The Subcommittee has before it, S. 477, the Consumer Rail Equity Act, which provides an opportunity for Congress to address the failure of the ICC to implement the Staggers Act as Congress intended without a wholesale reregulation of the railroad industry. The Consumer Rail Equity Act is the next logical step following the Danforth Resolution of 1984. S. 477 provides for a realistic revenue adequacy test and procedural fairness for captive shippers. It requires the ICC to take seriously its responsibilities for preserving competitive access. Through small but significant changes, the Consumer Rail Equity Act restores the balance of the Staggers Act, recognizing the realities of a deregulated railroad industry and the rights of captive shippers.

Mr. Chairman, many groups in my state support the Consumer Rail Equity Act. Two of these organizations have been particularly strong in their endorsement of the need to amend the Staggers Act—the North Dakota Public Service Commission and the North Dakota Wheat Commission. I would ask unanimous consent that their statements be included in today's hearing record.

Finally, I urge the Subcommittee to complete its hearings and move to a mark-up of S. 477. The ICC has failed to implement the captive shipper protection provisions of the Staggers Rail Act and only passage of S. 477 can ensure that such protections will be realized.

STATEMENT OF THE EDISON ELECTRIC INSTITUTE

The members of the Edison Electric Institute (EEI) appreciate the opportunity to address in some detail the problems which exist in the implementation of the Staggers Rail Act of 1980, and the need for legislative action in the form of S. 477, the Consumer Rail Equity Act, to restore a degree of balance between the interests of railroads and captive rail shippers under the law.

EEI is the association of investor-owned electric utilities. Our members serve 96 percent of all customers served by the investor-owned segment of the industry. They generate approximately 75 percent of all the electricity used in this country and serve, through either retail or wholesale electricity sales, 73 percent of all U.S. electric customers.

Each of our nation's investor-owned utilities is subject to public service commission regulation. Each is under an affirmative obligation to purchase the least expensive reliable source of fuel that is available, in order to try to minimize the cost of electricity to our customers. The cost of coal delivered to our generating facilities is composed of the minemouth price and the cost of transportation. Railroads are far and away the primary carriers of coal to electric utilities.

The total delivered cost of our coal is paid by the ratepayers, either through a fuel cost adjustment clause billing component or as a cost recovery element in base rates. Public service commissions do not allow utilities to make a profit on fuel costs.

Our message has as its foundation the critical relationship between the nation's railroads and U.S. coal-burning utilities. This relationship is complicated by the fact that many coal shippers and users have no alternative to service by a single railroad—they are what Congress referred to in 1980 as "captive shippers." Because the marketplace provides no protection for such shippers, the Staggers Act provides that the Interstate Commerce Commission (ICC) shall assure that the railroad rates charged such shippers are "reasonable". Through the adoption of a series of bad policies, however, the ICC has rendered virtually meaningless the Staggers Act "captive shipper" protections. In fact, since enactment of the Staggers Act, no coal shipper has obtained final, favorable relief in a rail rate case.[1]

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[1] The AAR [illegible] ed that there have been a total of seven decisions since the Staggers Ac [illegible] ail rates have been found unreasonable by the ICC. The seven cases [illegible] o. 1), Coal, Wyoming to Redfield, Arkansas; Docket No. 37409 Aggreg [illegible] Utah to Moapa, Nevada; and No. 38566, Rates on Iron Ore to [illegible] western; Docket No. 37338, *South Carolina Public*

Continued

Moreover, since the enactment of the Staggers Act, there have been a number of major rail mergers which have substantially increased concentration in the industry and in the process expanded the universe of captive rail shippers. We believe that Congress must act to put the ICC system back in balance by assuring that the captive shipper protections in the Staggers Act are implemented properly.

THE RAILROADS' POWER OVER UTILITY COAL TRAFFIC

Two facts must be kept firmly in mind as one examines the respective experiences of railroads and rail shippers under the ICC's regulatory policies over the past five years: (1) coal is the bread-and-butter commodity for the major U.S. railroads; and (2) electric utilities are by far the largest buyers and users of coal. This critical link between railroads and utilities provides and backdrop against which any serious discussion of rail regulatory policy must take place.

In 1984, electric utilities purchased over 700 million tons of coal, some 78 percent of the coal produced in the United States that year. Of this amount, almost two-thirds—460 million tons—was transported to power plants by rail. Electric utilities incur approximately $5.5 *billion* in rail freight charges each year, representing, on average, 35 percent of the total delivered cost of coal for power generation.[2] These rail freight charges are paid entirely by the utilities' ratepayers, and generate no profit or return for the utilities themselves.

The numbers are staggering from the railroads' side as well. Data developed by the Association of American Railroads shows that coal ranks highest among the commodities carried by rail in terms of tonnage.[3] Since 1976, while the aggregate volume of all other commodities has declined, coal tonnage has risen steadily and significantly.

Coal also provides the railroads with the most profit of any commodity. Because most shipments move in highly efficient unit train and trainload hauls, variable costs of service per ton-mile[4] are less than half those of other commodities (43 percent), according to an EEI study.[5] Even the ICC acknowledges that coal is one of the most profitable commodities.[6]

Service Authority v. *Clinchfield;* Docket No. 37450, *Central Illinois Light Co.* v. *Atchison, T. & S.F. Ry., et al.;* Docket Nos. 38184, 38185, 38186, *Pennsylvania Power & Light Co.* v. *Conrail;* and Docket No. 38738, *Western Farmers Electric Cooperative* v. *Burlington Northern.* None of these cases, however, resulted in final decisions actually implementing rate relief for the shippers. Two of them, the Redfield and the Moapa cases, were recalled from court appeals by the ICC on the grounds that they had been decided on pre-Staggers Act principles which were no longer valid. Both of these cases were recently reopened by the ICC for further consideration under the recently issued Coal Rate Guidelines. Although in both of these cases the ICC did find the challenged rates to be unreasonable, only in the Redfield case was the rate actually reduced, in the amount of 12 cents per ton. Seventeen months later the rate was increased once again. Reparations for past overcharges were also awarded in the Redfield case, but have never been paid by the railroad. In South Carolina, Central Illinois and Pennsylvania Power, initial decisions by Administrative Law Judges found rates unreasonable, but railroad appeals stayed the effectiveness of the relief ordered and the cases were subsequently settled. Western Farmers is still before the ICC on railroad appeal. Neither the rate reduction nor the reparations ordered by the ALJ in that case have yet been seen by the shipper.

The *Escanaba* case, involving rates on iron ore, was decided on the basis that the rate increase being challenged was in violation of a letter agreement between the shipper and the railroad. The syllabus of the ICC's printed decision indicates that its action in that case was to "enforce" a "contract" rate. Thus, this case was not decided in the traditional maximum rate reasonableness context.

Very recently, an Administrative Law Judge issued a decision in Docket No. 38783, *Omaha Public Power District* v. *Burlington Northern* which found certain unit train rates unreasonable and ordered reparations. It still remains to be seen whether the shipper will actually obtain the relief granted or whether, as in the other cases noted here, railroad appeals and ICC delay will turn the decision into yet another pyrrhic shipper "victory" which is ultimately without substance.

[2] Actually, in many cases the cost of transportation as a percentage of delivered fuel cost is much higher, sometimes as high as 80 percent.

[3] In 1984, coal accounted for nearly 40 percent of all tonnage transported by Class I Railroads. Source: "Railroad Facts," Office of Information and Public Affairs, Association of American Railroads, 1985 Edition, at page 28.

[4] A ton-mile is a measuring unit which describes the movement of one ton of traffic one mile.

[5] See "Coal Profitability Relative to Other Commodities," Edison Electric Institute, August, 1985 ("Coal Profitability") at 3.

[6] Evaluation of Studies Prepared by the Edison Electric Institute, Interstate Commerce Commission, Bureau of Accounts, November, 1985, at p. 13. The ICC's analysis indicates that three other major commodity groups had higher profit margins than coal, but the volumes of these

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Coal's profitability to the railroads is directly attributable to its status as a commodity that is largely rail captive. Because of the volumes and distances involved, as well as the location of mines and power plants, it is simply not feasible or practical to use motor or water carriers to haul coal to many utilities. Potentially competitive technology exists in the form of coal slurry pipelines, but extensive railroad land holdings and rights of way and the absence of federal eminent domain authority (due largely to railroad lobbying efforts) have combined to keep coal pipelines on the drawing board and out of the transportation market. Finally, boiler design specifications and environmental and energy use regulations effectively preclude the substitution of oil or gas for coal-fired power, and in many cases even operate to tie a utility to a specific coal source. In short, railroads often face no effective competition for hauling coal.

A study conducted for the ICC in 1982 [7] concluded that 53 percent of coal-burning utilities were effectively constrained from accessing competitive sources, railroads or modes in different geographic regions, a situation which was forecast to continue unabated well into the 1990's. A recent EEI survey found that approximately 64 percent of utility rail coal tonnage is captive to delivery by a single railroad. The previously cited EEI analysis of coal profitability shows that the average "revenue to variable cost ratio" for coal was approximately 180 percent. For all other commodities, the average ratio was 128 percent. This disparity reflects the strong rail market power over captive coal transportation.[8]

The railroads constantly claim that they are a "competitive industry," and that administrative scrutiny of their rates and practices is therefore unnecessary. It is, of course, true that with respect to much of their traffic, railroads do face competition from trucks, other railroads, and/or barge operators. This does not change the fact, however, that for a significant portion of their traffic, including much of their coal traffic, the railroads encounter little or no competition. Regardless of what the precise percentage of captive coal shippers may be, the evidence makes clear the reality that a great many coal shipments—particularly those for electric power generation—are captive to individual railroads.

This railroad market power makes rates on these shipments particularly susceptible to abuse, a point recognized by Congress in the Staggers Act when it called for a balanced approach to rail regulation and carefully retained statutory protections for captive shippers. However, the experience since 1980 has been marked by repeated failures on the part of the ICC to strike the proper balance. It is for this reason, and out of the frustration borne by captive shippers under the current regulatory regime, that we seek Congressional action.

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other commodities (and therefore the railroads' earnings from such commodities) pale in significance to the tremendous volumes of coal traffic carried by the railroads. In its January, 1986 update of its study, the ICC provides further data for 1982 and 1983 but this same statement is true for these subsequent years.

[7] "An Analysis of Source or Geographic Competition for the Delivery of Steam Coal to Utilities," Contract No. ICC-82-M-1731-D, July 26, 1982.

[8] Courts in antitrust cases have consistently held that the best indicator of market power is a firm's ability to set and maintain prices at supra-competitive levels. See, e.g., *United States* v. *E.I. duPont De Nemours & Co.*, 351 U.S. 377 (1956); *United States* v. *Grinnell Corp.*, 384 U.S. 563 (1966).

Recently, the ICC indicated its belief that the actual percentage of coal-burning utilities that are rail captive is small; somewhere on the order of 15-20 percent. This figure is based upon two studies, one conducted by the ICC staff, and the other by the Reebie Associates consulting firm. Both studies, however, are flawed, and grossly understate the problem of rail captivity for utility coal shippers.

The ICC study purported to compare railroad revenues from coal with rail service costs in an effort to determine how many coal rates were set at levels in excess of the revenue/cost ratio threshold for ICC jurisdiction—currently 180 percent. This "study," however, measured rail costs on the basis of total system averages—which reflect costs associated with movements of all sorts of commodities besides coal. Only a few of the adjustments to these costs routinely made and approved by the ICC in rail coal rate cases were made by the staff conducting the study. As a result, the costs are seriously overstated and the rate-to-cost ratios are correspondingly understated.

The Reebie Study is based on several assumptions which essentially "assume away" the captive shipper problem. The Study did not consider (a) long-term coal supply contracts binding coal users to specific sources; (b) environmental limitations on coal quality; or (c) existing legal and/or social barriers to new railroad entry or existing railroad expansion. It also assumed that the Commission would make aggressive use of its power to order reciprocal switching or terminal trackage rights to permit competitive access to coal sources and power plants.

THE ICC'S IMPLEMENTATION OF THE STAGGERS ACT HAS PREVENTED CAPTIVE COAL SHIPPERS FROM RECEIVING THE EQUITABLE TREATMENT CONGRESS INTENDED

Everyone who participated in the long and sometimes arduous legislative effort that went into the Staggers Act recognized that the final legislation represented a compromise of competing interests. The central compromise that made the Staggers Act possible was in the area of rail rates. Congress recognized that railroads needed the opportunity to generate sufficient revenues to achieve financial stability. Congress also recognized that captive rail shippers in general, and captive coal shippers in particular, should not be forced to pay excessive freight rates to railroads.[9] In crafting the Staggers Act, Congress carefully sought to balance these two policy concerns. However, in implementing the Act, the ICC has undermined the legislative balance by its decisions in a series of rulemaking proceedings which have ignored, eliminated, or severely curtailed the protections Congress sought to accord captive shippers.

Congressional concern for captive shippers

Congress adopted as a Staggers Act policy goal: "to provide a regulatory process that balances the needs of railroads, shippers, and the public."[10] Insofar as rail ratemaking was concerned, Congress stated that the ICC should act "to foster sound economic conditions in transportation" while, at the same time, act "to maintain reasonable rates where there is an absence of effective competition."[11]

Maintenance of fair transportation rates on coal traffic was of particular concern to Congress. Congress considered coal traffic to be the prime example of a commodity over which railroads possess market dominance, and cautioned that railroads should not be permitted to meet a disproportionate share of their revenue needs by charging excessive rates on coal traffic. As stated by the Senate Commerce Committee concerning its version of the Staggers Act:

> This bill provides continued protection for shippers where such protection is necessary in the public interest. The [Senate] Committee [on Commerce, Science and Transportation] expects this protection to be utilized by the Commission to prevent extensive cross-subsidization or an excessive contribution from captive traffic. *The rates on coal are of particular concern in view of the many substantial increases imposed on this traffic in the last several years.* While recognizing that not all traffic can be transported at a fully allocated cost level due to competitive considerations, it is the Committee's intent that the Commission play an active role in insuring that such traffic bears its fair share of costs and that higher rated captive traffic is not unduly burdened. (Emphasis added).[12]

The Staggers Act Conference Report also emphasized Congress' special concern for coal:

> The Conferees intend that this [rail transportation] policy include the encouragement and promotion of the transportation of coal by rail in accordance with the objective of energy independence at rates which do not exceed a reasonable maximum where there is an absence of effective competition.[13]

Indeed, the Staggers Act is a compromise which passed solely because of assurances built into the structure and policies of the legislation, that regulation would be maintained where marketplace competition was insufficient to protect captive shippers and the public from abusive practices by the railroads. As stated by Congressman Rahall, author of a key compromise amendment which enabled the legislation to pass:

> [M]y involvement in the rail legislation now before the House was to assure that a balance was struck, a balance which would allow carriers to achieve adequate revenues while providing protection for captive shippers against unjustifiably high rail rates. I believe this balance has been struck and urge support for the Conference Report.[14]

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[9] That the goal of revenue adequacy was not intended to predominate over considerations of reasonable rates is made clear in the Report of the Committee on Conference on the Staggers Act: The Conferees intend that the Commission give due regard to two things whether a rate increase would mean excessive profits, and the need for a rate increase in light of the carrier's revenue position. This language is not intended to imply that excessive profits for inadequate revenue carriers are reasonable. H.R. Rep. No. 96-1430, 96th Cong. 2d. Sess. 94 (1980).

[10] Staggers Rail Act of 1980, Public Law No. 96-448, § 3, 94 Stat. 1895, 1897 (October 14, 1980).

[11] *Id.* § 101(a), 94 Stat. 1897, codified at 49 U.S.C. § 10101a (5) and (6).

[12] S. Rep. No. 96-470, 96th Cong. 1st Sess. 7 (1979).

[13] H.R. Conf. Rep. No. 96–1430, 96th Cong., 2d Sess. 80 (1980). The importance of coal to Congress is underscored by the fact that the quoted language was the only substantive comment in the Conference Report on the rail transportation policy in section 10101a.

[14] 126 Cong. Rec. H10086–87 (daily ed., Sept. 30, 1980).

The legislative balance of shipper and railroad interests incorporated into the Staggers Act has been acknowledged repeatedly by reviewing courts in post-Staggers Act cases construing the Act.[15] Perhaps the best judicial expression of the balancing of interests that lies at the heart of the Staggers Act was provided in a 1984 decision by the D.C. Circuit overturning the ICC's decision to deregulate rail transportation of export coal:

> Congress recognized that sometimes competition would be insufficient to protect the legitimate interests of shippers, small carriers, and the public, and thus that full deregulation of the industry was unjustified by industry conditions. The legislation that eventually became the Staggers Act was subject to significant modification during floor debate, with many of the successful amendments supported by legislators who feared that the bills that emerged from the committees might not afford adequate protection to shippers where they might otherwise suffer from abuses of market power. The resulting Act was a compromise that enjoyed overwhelming support. Although the legislation was without doubt a significant reduction in railroad regulation, as this court has said, "The legislation . . . did not strip the Commission of its power and duty to protect shippers from the unreasonably high rates of carriers with market dominance." *Burlington Northern Inc.* v. *United States*, 661 F.2d 964, 973 (D.C. Cir. 1981). Both before and after the amendments the bills' sponsors agreed that the underlying approach of the legislation was to move toward much greater reliance on market forces rather than regulation to govern rail carriage, but to temper that move with a policy of retaining regulation where the market would be insufficient to protect shippers and the public from abusive railroad practices.[16]

* * * * * * *

The text of the Staggers Act and its legislative history emphasize that the ICC must consider and balance the interests of captive coal shippers in its regulatory actions. Despite this clearly stated intent, however, the ICC has not accomplished the balancing task Congress intended it to pursue. Instead, through a series of general rulemaking proceedings and individual cases, the ICC has nurtured a one-dimensional regulatory environment which views the accumulation of railroad revenues and profits as the only goal worthy of serious service. For utility coal shippers, the combined effect of these actions has been to permit the market dominant railroads to establish and maintain unreasonably high rates on volume movements of their necessary fuel.

THE RAILROADS HAVE BEEN ALLOWED TO CHARGE EXCESSIVE RATES FOR COAL TRANSPORTATION

One of the statistics repeatedly referred to by the railroads and the ICC traces the average rail rate increases on coal since enactment of the Staggers Act in comparison to the performance of various inflation indices for the same period. The rough similarity in these figures is then asserted as "proof" that ICC implementation of the Staggers Act has not permitted rail market power abuse of captive coal shippers in the area of rates. The argument is misleading for at least two reasons.

First, using a general average of all rate increases fails to reflect major increases on individual movements. Second, the railroads and their supporters ignore the fact that for a significant number of coal burning utilities, the most significant harm flowing from ICC policies under the Staggers Act is found in the protection and perpetuation of pre-Staggers Act rate actions, rather than the encouragement of post-1980 abuses. The railroads and the ICC claim to have looked for abuse and found none. In truth, they have been deliberately looking in the wrong place. As even the railroads' own studies show, a more meaningful period of time for viewing the extent to which captive rail rates have increased is the period since passage of the 4-R Act in 1976. During the period 1976-1980, when the ICC's then-current methodology showed that over one-third of the Class I railroads in the United States already were earning adequate revenues, rail rates on coal increased approximately

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[15] *See e.g.: Burlington Northern, Inc.* v. *United States*, 661 F.2d 964, 973 (D.C. Cir. 1981); *Cleveland Cliffs Iron Co.* v. *ICC*, 664 F.2d 568, 587 (6th Cir. 1981); *Iowa Public Service Co.* v. *ICC*, 643 F.2d 542, 548 (8th Cir. 1981); *Union Pacific R.R.* v. *United States*, 637 F.2d 764, 767 (10th Cir. 1981); *Celanese Chemical Co.* v. *United States*, 632 F.2d 568, 577 (5th Cir. 1981) cert. denied *Atchison, Topeka & Santa Fe R. Co.* v. *United States* 453 U.S. 950 (1981).

[16] *Coal Exporters Ass'n* v. *United States*, 745 F.2d 76, 81 (D.C. Cir. 1984) (footnotes omitted), cert. denied, 53 U.S.L.W. 3772.

62 percent, far more than the rate of inflation, which was approximately 27 percent.[17]

To a large extent, however, the question of how fast and how much rail rates for coal have increased is beside the point. The statistic cited by the ICC and the railroads will not answer the truly important question: whether the ICC has formulated policies which are allowing the railroads to charge excessive rates on captive coal traffic. For this answer, one must focus instead on the impact of ICC policies on the profits earned from those rates.

In January, 1986, the railroads issued an "analysis" of rail freight rates under the Staggers Act and throughout the period immediately prior to its passage.[18] Of the ten analytical tests applied in the study, however, none measured the most important element for purposes of this debate—the profitability of the rates under consideration. We submit that had the railroads focused on this aspect, the available evidence on coal profitability would confirm that ICC policies since 1980 have fostered excessive rail rates on captive coal.

It is important to note that the vast majority of coal transported by rail moves in highly efficient unit train or trainload shipments. Also, utility shippers are increasingly providing their own equipment, thereby reducing the railroad's costs. Utilities currently own more than 33,000 coal cars, a ten-fold increase in the last ten years, and have made substantial investments in terminal facilities. All of this must be considered in tandem with recent, substantial productivity increases in the railroad industry itself (e.g., reduced crew sizes, more efficient locomotives, decreased turnaround times, etc.).

The Edison Electric Institute has conducted an analysis of the profitability inherent in the tariffs of 19 specific captive utilities. The analysis was made after a recent DOE study of railroad rates failed to investigate the profitability of the rates being charged to the eight utilities studied. Our analysis used standard ICC methodology for determining and allocating costs and relied primarily upon data provided to the ICC by these companies in their rate complaints. The analysis accounted for unit train efficiencies experienced in those haulages. The analysis showed that the pre-tax returns on investment to the railroads inherent in these coal tariffs ranged from a low of 51 percent to a high of 157 percent. (See Tables included as Attachment 1.)

Although the AAR and the ICC have challenged the validity of our profitability analysis for these 19 movements, we have confirmed that the costing in the analysis was performed in accordance with the procedures normally utilized in trainload and unit train coal rate cases before the ICC. Attachment 2 to this Statement contains a brief response to the unfounded criticisms of this analysis which have been leveled by the AAR and ICC.

A few of the utilities involved in the DOE study and our analysis have since experienced the benefits of newly-arisen competition and have negotiated rail contracts at reduced rates. Most, however, along with the majority of other coal shippers, remain without competitive alternatives and continue to pay rates which generate extraordinary returns.

The substantial rate reductions that have occurred in those few instances where competition has intruded into a formerly captive rail haulage situation also provide strong evidence that some captive coal shipper rates are excessive.

The City of San Antonio's problems with its Burlington Northern rail rates are well known. From 1976 to 1985, the San Antonio public utility, which was captive to the Burlington Northern for its Powder River Basin, Wyoming coal, experienced an increase in coal rates from $10.93 to $27.66 per ton. In early 1985, after the Chicago and Northwestern Transportation Company was allowed to enter the lower part of the Powder River Basin to compete with the Burlington Northern, San Antonio received public bids from both railroads. When the bids were opened, the C&NW had won with an effective rate of approximately $19.60 per ton, a reduction of $8.06 per ton or 29 percent. In addition, Burlington Northern had offered to reduce its own rate $4.66 per ton, or 17 percent, in an effort to keep the business. The winning rate reduction per ton was greater than the amount of money San Antonio was paying for its coal at the mine mouth.

Certain other utilities in the Southwest have benefited from this same infusion of competition, and have received significant rate decreases, ranging from an estimated 18 to 29 percent. A summary of some of these cases is shown below:

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[17] *See* "Review of Association of American Railroads Paper 'Coal Rate Facts'," Edison Electric Institute, June, 1984, at 9.

[18] "Railroad Freight Rates In The Five Years Since Staggers," Economics & Finance Department, Association of American Railroads, January, 1986.

THE EFFECT OF COMPETITION ON RAIL RATES

Shipper	Old Captive Rate	New Competitive Rate	Reduction	Percent Reduction
San Antonio (City Public Service)	$27.66 (BN)	19.60 (CNW)	8.06	29
		23.00 (BN Bid)	4.66	17
Lower Colorado River Authority	26.67 (BN)	22.00 (BN)	4.67	18
Arkansas Power and Light	23.00[1] (BN)	18.50[1] (CNW)	4.50	20
Houston Lighting and Power	25.73 (BN)	19.00[1] (BN)	6.73	26
Southwestern Public Service	17.50 (BN)	12.50[1] (BN)	5.00	29

[1] Estimated

A number of the tariff rates that were being charged to the utilities listed above prior to the introduction of competition had been litigated before the ICC, and in each case the railroads took the position that they yielded earnings far below levels necessary to generate a sufficient return on investment to attract capital and produce a fair profit. Yet, when faced with the realities of the marketplace, significant reductions suddenly became possible. Notwithstanding that the ICC never ordered a reduction in any of these challenged tariff rates, the railroads themselves found ample room to offer major reductions and still maintain an acceptable profit margin.

Unfortunately, competition is not likely to develop for the majority of captive shippers. To the contrary, the trend among major railroads is not toward new market entry, but consolidation and concentrations of market power:

Burlington Northern acquired the St. Louis-San Francisco Railway in 1980.

The Chessie System Railroads and the Seaboard Coast Line Railroad were consolidated in 1980 under the umbrella of the CSX Corporation.

Union Pacific acquired the Missouri Pacific and Western Pacific in 1982.

In 1982, the Norfolk & Western Railroad and the Southern Railway were consolidated under the common control of Norfolk Southern Corporation.

In a case that is still pending before the ICC, the Santa Fe and the Southern Pacific are seeking authority to conduct operations under one corporate umbrella.

In a dramatic extension of intermodal market power, CSX Corporation acquired American Commercial Barge Lines in 1984.

If the pending sale of Conrail to the Norfolk Southern system (parent of the "revenue inadequate" Norfolk & Western Railway and Southern Railway) is approved, three major railroad systems will handle over 80 percent of all coal traffic in the United States, and over two-thirds of the coal delivered to captive power plants.

The handsome returns which the major railroads are earning on volume coal movements, coupled with the dramatic reductions in rates which can (and do) occur when bona fide competition is introduced, demonstrate both the profitability of captive coal traffic and the rate victimization which takes place today in areas where competition does not exist. In some instances, excessive rates have been in effect since before 1980—and the ICC's policies have operated to preserve an inequitable situation. In others, those policies have led directly to new rate increases, pushing rates to excessive levels. In either case, however, it is clear that the ICC's administration of the Staggers Act has effectively given the railroads carte blanche on their captive traffic—particularly their coal traffic. The existing regulatory system, which imposes no effective limitation on the degree of differential pricing which railroads are able to impose on captive shippers, is desperately in need of repair. After more than five years of this intolerable situation, it is to the Congress that captive shippers must turn for relief.

THE CONSUMER RAIL EQUITY ACT WILL REMEDY THE ICC'S FAILURE TO PROTECT CAPTIVE SHIPPERS

The law provides that a captive shipper who is concerned about a railroad rate may petition the ICC to have the reasonableness of the rate adjudicated. Prior ICC approval of rail rates is not required. Rather, the railroad establishes the rate by filing a tariff rate for the shipper in question. In certain very limited circumstances, the ICC does have the power to suspend a filed rate prior to its going into effect and/or to start an investigation into its reasonableness before it takes effect. In such a case, the railroad would bear the burden of proving the challenged rate to be reasonable, but the ICC has only used this investigation power in very rare circumstances since 1980. As a rule, therefore, if the shipper believes the rate is excessive, the shipper must petition the ICC for relief through the filing of a complaint once the rate has become effective.

To contest the reasonableness of a rate, a shipper must first prove that it is a "captive shipper" by proving (1) that its rate exceeds a jurisdictional revenue-to-variable cost threshold and (2) that the shipper is subject to railroad "market dominance". Market dominance means that the shipper has no effective alternative but to ship to commodity in question via the railroad(s) charging the challenged rate. Having proved that it qualifies as a captive shipper, the shipper, not the railroad must then carry the burden of proof as to the unreasonableness of the rate. Determination of rate unreasonableness involves the "revenue adequacy" test and the "rate reasonableness" test. In addition, a shipper cannot contest any rate increase which is based upon the ICC inflation index developed pursuant to Section 203 of the Staggers Act.

The test for revenue adequacy, rate reasonableness and market dominance, along with the manner in which the ICC determines and applies its inflation index, are the four principal areas where the ICC's failure to implement Congressional intent has had the most serious consequences for captive shippers. Each was the subject of separate ICC rulemakings, which are discussed below. The ICC's handling (or mishandling) of the matters at issue in these proceedings points out the type of legislative relief which is urgently needed to restore the balance of interests struck by Congress in 1980. Such relief, in an appropriate and carefully limited form, is contained in the provisions of the Consumer Rail Equity Act.

1. Revenue adequacy

Using standards developed in Ex Parte No. 393,[19] the ICC has determined that every Class I railroad in the United States is "revenue inadequate." [20] In order for the railroad industry to obtain "revenue adequacy" as defined by the ICC, billions of dollars in additional freight revenues must be contributed to the railroad system by shippers.

This situation is devastating to captive shippers because in every case where rail rates are challenged as being unreasonably high, the railroads refer to the massive influx of dollars the ICC has declared the railroads need in order to be "revenue adequate" as a justification for charging monopoly rates. Such arguments have been very successful, and the ICC has constantly referred to the need of individual railroads to achieve revenue adequacy as the overriding consideration justifying extremely high rates on captive coal traffic.[21]

The ICC's view of the financial needs and revenue adequacy of the nation's railroads has distorted the balance between railroad revenue needs and individual rate reasonableness requirements which Congress sought to foster in the Staggers Act. In order to fully understand this problem, it is necessary first to understand why the concept of "revenue adequacy" is so crucial to the correct working of the Staggers Act; to understand the key errors in the ICC's decision in Ex Parte No. 393; and finally to understand the substantial public criticism of the ICC's misguided standards.

(a) The Importance of the Revenue Adequacy Concept in the Staggers Act.

The "revenue adequacy" standard was born in the Railroad Revitalization and Regulatory Reform Act of 1976,[22] and called upon the ICC to analyze relevant railroad financial data and determine which railroads are not financially sound, i.e., which railroads are "revenue inadequate." Revenue adequacy determinations directly affect rates subject to ICC regulation—rates to captive shippers. For this reason, the regulatory function of these determinations is quite comparable to the function utility regulatory commissions perform when identifying revenue requirements for the companies they regulate.

The railroads claim to the contrary. They argue that revenue need standards used for utilities are inappropriate for railroads because of the "competitive nature" of most rail markets. This argument wholly misses the point, however. The concept of railroad revenue adequacy only has practical relevance in the context of captive traffic—traffic without effective competitive alternatives. As such, it is, in fact, a standard applicable *only* in monopoly circumstances.

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[19] Ex Parte No. 393, Standards for Railroad Revenue Adequacy, 45 Fed. Reg. 80150 (Dec. 3, 1980) (Notice of Proposed Rulemaking); 364 I.C.C. 803 (1981) (final decision).

[20] *See e.g.*, Ex Parte No. 475, Railroad Revenue Adequacy—1983 Determination (Decision served Jan. 4, 1985) ("the Commission has now determined that none of the 32 Class I carriers are revenue adequate." Id. at Sheet 1).

[21] See e.g., *Potomac Electric Power Co. v. Consolidated Rail Corp.*, 367 I.C.C. 532, 537. The ICC's specific rail rate reasonableness policies are discussed later in this statement, but it must be noted from the outset that the Commission's views concerning railroad revenue adequacy lie at the heart of its rate reasonableness policies.

[22] Railroad Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31 (1976) (hereinafter cited as "4-R Act"), and currently codified at 49 U.S.C. § 10704 (a)(2).

In 1978, the ICC established regulatory standards and procedures for measuring railroad revenue adequacy, [23] deciding that it would look at "all pertinent financial indicators" to judge the financial strength of individual railroads. Using this approach, the ICC found in 1979 that 11 of the 31 Class I railroads enjoyed adequate revenues.[24] Despite urgings from the Nation's railroads during the Staggers Act debate that the Commission was improperly measuring railroad revenue adequacy, Congress refused to change the definition of revenue adequacy set forth in the 4-R Act. Congress did, however, direct the ICC to make revenue adequacy determinations each year.[25]

The Staggers Act also made structural changes in the law designed to give revenue inadequate railroads greater rate freedoms then revenue adequate railroads. Thus, Congress specifically required that the ICC consider its revenue adequacy findings in individual rate cases; required the ICC to give "due consideration" to a railroad's revenue adequacy status in evaluating challenges to rate increases within the 6 percent "zone of rate flexibility" applicable through October 1, 1984; [26] precluded revenue adequate railroads from using the rate freedoms under the 4 percent rate flexibility zone commencing in October, 1984; and required the Commission to take into account the revenue adequacy of a railroad in connection with the rate surcharge provisions of the Staggers Act.[27]

Given the role which the revenue adequacy concept plays under the Staggers Act, it is of fundamental importance that the standards used to determine a railroad's revenue adequacy comport with financial reality. To the extent that the ICC declares a railroad to be revenue inadequate when in reality it is not, the entire structure of the ratemaking provisions in the Staggers Act is skewed. This is precisely what has happened through the ICC's Ex Parte No. 393 decision.

(b) The Commission's Ex Parte No. 393 Decision.

Soon after the Staggers Act was passed, the ICC initiated a rulemaking proceeding for purposes of "revising" the standards it had previously used for purposes of making revenue adequacy determinations. In this proceeding the Commission decided to determine rail revenue adequacy based solely upon a railroad's return on the total value of its assets.[28]

Using this criterion, the Commission has determined that none of the nation's Class I railroads are "revenue adequate" and that the "revenue shortfall" (the difference between the amounts of money the railroads need to receive to be revenue adequate and the amount they currently are receiving) amounts to several billion dollars.[29]

While the ICC revenue adequacy standards use financial terminology similar to that used by the financial community and other regulatory agencies, the actual regulatory precepts used are far different from those generally applied to regulated industries—and electric utilities in particular. As stated by Dr. Wesley H. Long, District of Columbia Public Service Commissioner and Chairman of the National Association of Regulatory Utility Commissioners '(NARUC) Subcommittee on the Staggers Act Implementation:The ICC's methods result in overstated costs and understated returns on the railroads 'investment. The end result is that rail freight customers, especially those, such as coal shippers, having no other practical means to transport their freight, are burdened with excessive transportation costs. Such costs are passed on to the consuming public in the form of higher rates for electricity and other goods or commodities.

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[23] Ex Parte No. 338, Standards and Procedures for the Establishment of Adequate Revenue Levels, 358 I.C.C. 844, modified, 359 I.C.C. 270 (1978).

[24] Ex Parte No. 353, Adequacy of Railroad Revenue (1978 Determination), 362 I.C.C. 198 (1979).

[25] Staggers Act § 205(b)(2), 94 Stat. 1906, codified at 49 U.S.C. §10704(a)(3), (4).

[26] Under Section 203(a) of the Act (codified at 49 U.S.C. §1070a (c) and (d)), Congress established "zones of flexibility" with respect to rates. Between October 1, 1980 and September 30, 1984, railroads were permitted to take annual rate increases of up to 6 percent after inflation. As of October 1, 1984, the flexibility zone was reduced to 4 percent per year, and is only available to revenue inadequate carriers. Rate increases within the zone cannot be suspended by the ICC prior to their effectiveness, and can only be investigated on the Commission's own initiative under limited circumstances. A shipper, however, can still file a complaint challenging the reasonableness of a rate as augmented by an increase within the flexibility zone.

[27] Section 217 of the Act gave railroad parties to joint rates the power to impose unilateral surcharges on their portion of the joint rate without the necessary concurrence of other connecting carriers. This mechanism was designed to allow railroads with disproportionately low shares of joint rates to increase their revenue without having to convince the other participants to either raise the entire rate or reduce their own shares. The surcharge power expired on October 1, 1984.

[28] Ex Parte No. 393, Standards for Railroad Revenue Adequacy, 364 I.C.C. 803 (1981).

[29] Ex Parte No. 457, supra, note 1.

The ICC substantially overstates railroad revenue adequacy requirements in a number of ways. For example, in making revenue adequacy determinations:

The ICC includes the current, market cost of debt rather than the cost of debt which the railroads actually pay.

Much railroad debt was issued many years ago, when interest rates were lower than those which currently prevail. Pretending, as the ICC does, that all debt was issued in the current period at current costs overstates the true cost of railroad debt and, thus, the revenues needed to meet that cost. By contrast, other regulatory commissions generally consider debt at its actual, incurred cost.

The railroads claim that the imaginary, current debt cost must be used because during times of low interest rates, when a new entrant's capital costs would be lower than the existing railroad's costs, the existing firm's rates will be limited by the new entrant's lower cost of debt (and, thus, lower rates). The railroads say that measuring their financial performance using imaginary, current debt costs during periods of high interest rates is necessary so that this "shortfall" can be balanced out. The flaw in this argument is that it assumes that a company with higher-than-current actual debt costs would not refinance at lower levels when interest rates decline. In fact, all companies—regulated and competitive—refinance debt when interest rates decline. Electric utilities refinanced over $3 billion in debt in 1985 alone. In addition, it ignores the fact that the ICC's regulatory authority is limited to situations where competition does not exist. In the real world (where the theoretical new entrant does not, in fact, exist), the ICC's standard gives the railroads a license for higher-than-necessary captive shipper revenues when current debt costs are higher than actual costs, and the necessary revenues (through refinancing) when current costs are lower. An actual cost standard would always produce a figure at the "necessary" level; precisely the level mandated by Congress in its definition of revenue adequacy.

The ICC treats funds from deferred taxes as though they were obtained at the current market cost of private capital, even though such funds are obtained at no cost. This overstates the true revenue needs of the railroads.

Deferred tax funds are acquired at no cost to the railroads, but they are treated by the ICC as having been obtained at the current cost of capital. This further overstates the revenue needs of the carrier being analyzed, and has the effect of forcing captive shippers to cover imaginary railroad costs. Other utility regulatory commissions generally treat funds from deferred taxes as having no cost, or exclude such funds from the company's investment base. Both approaches provide the regulated entity the opportunity to use the funds while protecting customers from having to cover imaginary costs.

The railroads and the ICC argue that failing to include deferred taxes in a railroad's investment base for purposes of analyzing a railroad's revenue adequacy would deprive the railroad of the opportunity to earn a return on these funds. This argument is incorrect. In competitive markets, where railroad rates are unregulated, the achievement of revenue adequacy would not constrain rates, and railroads would have the same opportunity as unregulated businesses to maximize their return from deferred taxes. However, to the extent that the attainment of revenue adequacy serves as a constraint on rates to captive traffic, exclusion of deferred taxes from the investment base assures that rates to captive shippers would be based on capital costs actually incurred in providing rail service, and not on additional imaginary costs as well.

The ICC determines railroad debt-equity ratios on the basis of current market levels, rather than actually-incurred costs, and makes no judgment as to the prudence of the railroads' capital structures.

Because the ICC makes no determination regarding the prudence or reasonableness of each railroad's capital structure, captive shippers may be forced to provide the railroads with revenues to cover capital costs that are unnecessarily high because they bear no necessary relation to the realities of a railroad's actual capital structure requirements.

The ICC fails, by its own admission, to ensure that all railroad-related revenues, investments and expenses are included in the revenue adequacy determination.

Any determination of railroad revenue adequacy should take into account all revenues, investments and expenses reasonably related to the provision of railroad service, but the ICC has no mechanism to comprehensively identify and scrutinize such data. This can have significant impact upon the accuracy of the revenue adequacy determination. For example, if that determination is based upon an excessive investment base, the revenues required to attain revenue adequacy will be overstated. Shipper concerns that railroad investment bases may be overstated were recently confirmed when CSX Corporation announced an asset write-off of almost $1 billion, which included a great deal of railroad property. This property has been included by the ICC, without scrutiny, as part of the investment base upon which captive shippers should be required to pay a return.

The ICC's revenue adequacy methodology provides no opportunity to analyze or contest data supplied by the railroads.

Although the revenue adequacy determination has a clear relationship to rates for captive shippers, the ICC revenue adequacy determination procedures rely almost exclusively upon data supplied by the railroads. With the exception of the cost of capital determination, shippers and the public have no opportunity to participate in revenue adequacy determinations to scrutinize and comment upon the railroads' representations to the ICC.

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In the words of an ICC Administrative Law Judge: "Using the present method of arriving at a finding as to which carriers are revenue adequate it will be difficult if not impossible for any carrier to be considered revenue adequate. [30] The methodology for measuring railroad financial health as defined by the ICC is unique, not consistent with methods applied by other regulatory bodies, and virtually guaranteed to grossly understate the financial health of the major coal-carrying railroads.

If practices generally applied by utility regulatory commissions were used, a far more realistic view of the railroads' economic health would emerge. Under the current ICC standards, these railroads will continue to fall far short of revenue adequacy for years to come.

(c) Public acknowledgement of the ICC's revenue adequacy errors.

Perhaps the best example of the problem with the ICC's current revenue adequacy standards involves the Norfolk Southern Corporation. The Norfolk Southern controls the Norfolk & Western and Southern Railways, from which it derives the vast majority of its revenues. Both of these railroads have been determined to be revenue inadequate by the ICC because their "rates of return" as calculated by the ICC in its most recent determination are less than 5.4 percent—substantially below the 15.3 percent return the ICC established as the minimum needed to achieve revenue adequacy at the time. However, the Department of Transportation has chosen the Norfolk Southern as its candidate to purchase Conrail—at a cost of at least $1.2 billion—specifically because of its vibrant financial health, prospects for long-term profitability, and anticipated resilience in the face of future potential economic downturns. The DOT's long-term analysis, incidentally, directly contradicts the ICC's attempt to explain NS's cash-rich position as merely an aberration brought about by one-time tax write-offs.

(d) Proposed revisions to revenue adequacy standards.

The ICC now has under consideration new revenue adequacy standards which it proposed in 1983.[31] Rather than making the ICC's approach more consistent with that of other regulatory agencies, however, these proposed new standards would obscure railroad financial health even further. The most consequential of the new proposals would value the railroads' investment base on the basis of current cost rather than original cost. (It is unclear whether the ICC would apply reproduction or replacement cost.) Adoption of this methodology would by itself increase the railroad industry's apparent revenue "needs" very substantially. The ICC's most recent revenue adequacy determination shows that under its proposed revisions virtually all railroads, including the Norfolk & Western and Southern, would actually report negative returns.[32]

Although it has been suggested that it is necessary to value the investment base at current cost levels in order to take account of inflation, under the existing methodology—relying upon original cost depreciation and the nominal cost of capital—inflation is accounted for by use of the nominal, as opposed to the real, cost of capital.

(e) ICC admission of error.

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[30] No. 37854S, *Consumers Power Company* v. *Norfolk & Western Ry. Co.*, Decision served January 18, 1984.

[31] Ex Parte No. 393 (Sub-No. 1), Standards For Railroad Revenue Adequacy, Decision served March 9, 1983.

[32] Ex Parte No. 457, Railroad Revenue Adequacy—1983 Determination, served January 4, 1985, Appendix C, p. 1.

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Although Chairman Gradison of the ICC defended the Commission's revenue adequacy standards in her recent testimony before the House Subcommittee on Commerce, Transportation and Tourism on February 6, 1986, in testimony before this Subcommittee just two weeks later, on February 21, 1986, she confessed that the ICC now unanimously recognizes that its revenue adequacy standards are flawed. Specifically, in her written statement to this Subcommittee on behalf of the ICC, Chairman Gradison stated:

. . . we agree that our existing standards and procedures for determining revenue adequacy are not producing a realistic picture of the financial condition of the rail industry. The Commission's most recent revenue adequacy determination finds that in 1984 no railroad was revenue adequate. In fact, comparison of our revenue adequacy determinations for each of the five years from 1980 through 1984 shows a decline in the economic health of most of the major carriers, and only a minor improvement for others. This is directly contrary to the general perception shared by the government, the rail industry, the shipping public, and the investment community, that the financial condition of the railroads has improved substantially since passage of the Staggers Act. We have therefore concluded that our present standards, including our past decision not to consider multiple financial indicators must be reassessed. (Written Statement, at pp. 12-13.) This is a startling admission by the ICC, in light of the fact that it has repeatedly and emphatically refused to acknowledge the wide disparity between the results produced by its revenue adequacy standards and the realities of the railroads 'financial situation as perceived by the rest of the world.

While EEI is gratified that the ICC has come to the realization that its revenue adequacy standards are flawed, it cannot accede to the ICC's suggestion, in its testimony before this Subcommittee, that it should be permitted to reassess its standards and remedy the situation solely through the administrative process. Rail shippers fully exhausted the administrative and judicial review process on the revenue adequacy standards before any attempt was made by them to bring this issue before the Congress. The ICC must not be permitted, at the eleventh hour, to forestall Congressional action to deal with this problem on the basis that it intends to reconsider the entire matter. It is not at all clear what the ICC might propose to do about correcting the problem it now acknowledges with its standards, and it is entirely possible that after reconsideration whatever action it might take would fail to remedy the problem.

It is clear that the ICC's standards for determining railroad revenue adequacy are unrealistic. Because of the importance of the revenue adequacy concept in the overall construction of the Staggers Act, the ICC's flawed implementation of this statutory standard has undercut the entire statutory scheme. This situation has persisted for over five years despite repeated efforts by shippers to have the revenue adequacy standards changed. The time has come for Congressional action to address this critical area.

(f) The Consumer Rail Equity Act Would Correct the Errors in the ICC Revenue Adequacy Standard.

Some relatively simple statutory provisions addressing standards for revenue adequacy would effectively correct the flaws in the methodology presently employed by the ICC and bring the ICC's depiction of the railroads' financial health more in line with that seen by the financial and investment communities and the general public. Such an approach is embodied in Section 7 of the consumer Rail Equity Act. In short, it would:

Require that revenue adequacy determinations be based upon all actual investments, revenues and expenses reasonably related to rail service;

Exclude no-cost deferred tax funds from the investment base upon which the revenue adequacy determination is made;

Require that the cost of debt be based upon the actual cost of debt incurred by the railroad under scrutiny;

Require that the cost of equity capital be determined on the basis of all relevant financial information.

Determinations of revenue adequacy based upon these elements will result in much more accurate portrayals of a rail carrier's financial health and of the levels of differential pricing which legitimately may be imposed upon captive shippers. Under a methodology employing these elements several of the same railroads found by the ICC to be revenue adequate in 1979, and whose financial condition has improved steadily since the late 1970's, today properly would be considered at or near revenue adequacy. Such results would be fully consistent with the concept of revenue adequacy as established in the 4-R Act and re-affirmed in the Staggers Act.

2. Coal Rate Guidelines

The electric utility industry has never opposed the concept of differential pricing as such. We know that for carriers to recover their full costs (plus a return) on all traffic, some captive traffic must be subject to above full-cost rates in order to offset below full-cost (but still compensatory) rates on competitive traffic. Such a principle is built into the Interstate Commerce Act, and we have no desire to see it purged. What we do strongly object to, however, is use of the term "differential pricing" as a talisman to justify excessive rate levels on captive—especially coal—traffic. The law clearly places limits on the extent to which captive shippers may be subjected to differential pricing. In its deliberations since 1980 on the subject of Coal Rate Guidelines, however, the ICC has as a practical matter refused to recognize them.

The Coal Rate Guidelines proceeding [33] was begun in 1978 to establish ratemaking standards to apply in individual coal rate cases at the ICC. The final guidelines were issued in this proceeding on September 3, 1985—some seven years after the proceeding was initiated. During this seven year period, numerous individual rate cases were heard by the ICC, which were decided using various "interim" ratemaking standards. Significantly, since the passage of the Staggers Act in 1980 no coal shipper has realized a permanent reduction in its rail rate as a result of ICC action.[34]

Indeed, rate case adjudication before the ICC is so one-sided (*i.e.*, the shipper loses) that one of the ICC's Administrative Law Judges took the extraordinary action, in a published opinion, of telling shippers not to bring cases because, regardless of the merits, the ICC would never grant any relief. As stated by ALJ Hopkins:

> While it might again be tilting at windmills, it appears to this Administrative Law Judge that the complainants are wasting an enormous amount of time, energy and money, proceeding with these cases before a Commission that has clearly shown that it is unable or unwilling to find a complained of rail rate to be above a maximum reasonable level where a carrier is not revenue adequate. The question as to what aspects go into deciding revenue adequacy is another matter. The Staggers Act as presently construed, even though on an interim basis, without Congressional changes and with a Commission as presently constituted, leaves no hope for complainant shippers.[35]

While the ICC's new Coal Rate Guidelines purport to balance the interests of railroads, shippers and the general public, in fact they do not provide meaningful protection for captive shippers as required by the Staggers Act. The ICC has adopted what it terms the "constrained market pricing methodology." This methodology contains four purported "constraints" on railroad pricing of captive traffic: The Stand-Alone Cost Constraint, the Revenue Adequacy Constraint, the Management Efficiency Constraint, and the Phase-In Constraint. An analysis of each of these "constraints" and their principal defects follows.

(a) The Stand-Alone Cost Constraint.

Under this "constraint," a shipper must prove that a rate is unreasonable by proving that it is higher than the cost the shipper would have to pay to provide the same service itself, or to obtain the same service from a hypothetical alternative transportation source. Since a stand-alone railroad hauling only the traffic of the complaining shipper will be astronomically expensive in all cases, a shipper first will have to analyze what other traffic also could be carried by the stand-alone railroad. Next, it will have to determine what rail plant (land for right-of-way, rails, ties, bridges, road crossings, maintenance facilities, signalling systems, etc.) and equipment (locomotives, cars, maintenance equipment, etc.) would be required to handle the defined traffic base. In order to make this determination, it also will be necessary for the shipper to work out an operating plan and define the labor force for the stand-alone railroad.

Once the operating plan, labor force, railroad plant and equipment requirements for the theoretical railroad have been established, the shipper must demonstrate what the cost of this entire enterprise would be. The final step would be to show

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[33] Commenced as Ex Parte No. 347, Western Coal Investigation—Guidelines for Railroad Rate Structure (notice served May 11, 1978); Ex Parte No. 347 (Sub-No. 1), Coal Rate Guidelines—Nationwide (Decision served Sept. 3, 1985) (Final decision).

[34] In a very few instances, an initial determination of unreasonableness has been made by an ALJ. With the exception of one very recent and still pending case, however, in each of such cases either the filing of an appeal by the railroads followed by an ICC order to hold the case in abeyance, or some other development has prevented the ALJ order from ever taking effect. See note 1, supra.

[35] Docket No. 37853S, *Consumers Power Co.* v. *Missouri Pacific Railroad Co.*, Decision served Jan. 18, 1984, at 8.

what portion of the cost of the stand-alone railroad should be borne by each segment of the traffic it would carry. All of this analysis must be conducted on the wholly theoretical proposition that a stand alone transportation alternative could somehow be possible, although in the real world numerous factors may rule out construction of alternative transportation systems regardless of economic considerations. Operating on this theoretical level necessarily entails tremendous uncertainty and speculation and presents fertile ground for dispute between the parties in a context where "real" facts may provide the ICC little basis for resolving issues. Even where the shipper attempts to demonstrate the cost of a stand-alone railroad based on the existing plant and operations of the railroad(s) providing the service under the challenged rate, the factual issues are of comparable complexity.

The shipper bears the burden of proof with regard to each and every element of this exercise of establishing the traffic base, plant and equipment requirements, operating parameters and labor requirements, costs and demand-based rate structure for the mythical stand-alone railroad.

In order to make the detailed evidentiary showings required to attempt to satisfy the requirements for a stand-alone cost analysis, a shipper must retain witnesses with expertise in at least the following areas: railway engineering, signalling systems, train operations, equipment maintenance, maintenance-of-way, railroad accounting, economics, and costing, as well as specialized counsel. This team of experts must then devote a massive amount of time to (a) efforts to obtain information necessary to conduct the required analysis, much of which is in the sole possession of the railroad and must be sought through the Commission's discovery procedures, (b) conduct and present the requisite analysis, (c) respond to railroad attacks on the analysis, and (d) dissect the counter stand-alone analysis which will ordinarily be presented by the railroad.

In short, the stand-alone cost constraint is, at best, a witheringly complex undertaking, entailing a massive amount of effort and tremendous expense. For this reason alone, it is totally out of the question as a meaningful "remedy" for many captive rail shippers. Even for those few shippers who may be able to afford to pursue a stand-alone cost case, under this type of analysis only shippers who are moving very large volumes of traffic for long periods of time over high density rail lines where a large percentage of the traffic is coal or other bulk commodities will have any faint hope of obtaining relief. Notwithstanding the law's mandate that rate relief be available to any shipper under railroad market dominance, the ICC proposes to follow a methodology which has as its major feature an element beyond the effective reach of all but a few shippers.

(b) The Revenue Adequacy Constraint.

As spelled out in the ICC's Guidelines, the revenue adequacy constraint dictates that "captive shippers should not be required to continue to pay differentially higher rates than other shippers when some or all of that differential is no longer necessary to ensure a financially sound carrier capable of meeting its current and future service needs." Apparently, the only way this constraint could be used to show an individual rate to be too high would be for a shipper to establish (a) that the railroad involved is revenue adequate, and (b) that the degree of differential pricing reflected in the challenged rate is not necessary for the railroad to remain revenue adequate.

As to the first element of this showing, the Guidelines make it clear that existing revenue adequacy standards will apply. Since Chairman Gradison has conceded that present revenue adequacy standards are being reassessed and, the ICC is delaying publication of a 1984 revenue adequacy determination, it appears that in attempting to apply these new Guidelines, shippers will be forced to rely on dated revenue adequacy determinations that are admittedly flawed. Further, the Guidelines stress that revenue adequacy is a long-term concept, and that the fact that a railroad may have adequate revenues for one or more years does not establish that it has "achieved" revenue adequacy. The ICC specifically declined to decide what period of time it may be appropriate to focus upon in determining revenue adequacy, leaving that for case-by-case determination. As to the second element of the showing required to invoke the revenue adequacy constraint, the ICC gives no indication of how it might be satisfied.

The ICC's failure to make any attempt to explain how a shipper might resort to this constraint is entirely understandable given the fact that under the current revenue adequacy standards, it is unlikely that any railroad will be found to have adequate revenues at any point in the reasonably foreseeable future. Despite the widely-acknowledged and well-documented disparity between the assessments of the railroads' financial health under the Commission's revenue adequacy standards and in the real world, the ICC, in the Coal Rate Guidelines decision, reaffirmed its standar[illegible] representing "a reasonable level of profitability for a healthy carrier." Until re[illegible]c standards of revenue adequacy are employed, the revenue adequacy constraint is utterly useless.

(c) The Management Efficiency Constraint.

The stated purpose of the management efficiency constraint is to protect captive coal shippers from bearing the costs of demonstrated railroad inefficiencies. This is the ICC'S claimed implementation of the Long-Cannon Amendment (49 U.S.C. § 10707a(e)(2)), the provision of law enacted in 1980 to protect captive shippers from excessive cross-subsidization of lower rated competitive traffic. The first step in conducting this analysis is to define the extent of a railroad's revenue need shortfall, namely the difference between its actual revenues and the level of revenues deemed to be adequate under the ICC's revenue adequacy standards. This revenue shortfall can then be reduced by the amounts of revenue losses or avoidable costs which the shipper can demonstrate are attributable to the railroad's inefficiency.

The ICC identifies three types of railroad inefficiencies which may be analyzed: operating inefficiencies, plant inefficiencies, and pricing inefficiencies. The decision does not elaborate on operating inefficiencies, but presumably an example might be a demonstration that a railroad makes a standard practice of using five locomotives to move a train where three would suffice. Presumably the cost associated with the use of the two unneeded locomotives would be disallowed in determining the railroad's revenue adequacy.

The analysis concerning pricing inefficiencies is performed on both a short-run and long-run basis. In order to develop the evidence necessary to make the necessary evidentiary showings concerning either plant or pricing inefficiencies, the shipper must conduct a cost analysis of the railroad's entire traffic base in order to identify traffic which may be moving at rates below either short-run or long-run marginal costs.

Any revenue losses or avoidable costs which the shipper can establish are attributable to railroad inefficiency will be deducted from the railroad's revenue shortfall. Once the "corrected shortfall" has been established in this fashion, the shipper will be required to demonstrate that the level of differential pricing contained in the rate under challenge is more than the amount of the railroad's revenue needs which properly can be allocated to its traffic under Ramsey Pricing principles.[36] To make this showing, the shipper must analyze the demand characteristics of all of the railroad's traffic in order to determine its appropriate "share" of the railroad's revenue needs.

The complexity, difficulty, and expense of the stand-alone cost analysis are dwarfed in comparison to the effort a shipper must undertake in order to pursue the management efficiency analysis. In order to determine whether a railroad's revenue shortfall is attributable, in part, to operating inefficiencies, the shipper must (a) analyze the railroad's operations to examine their efficiency; (b) conduct a cost analysis of all of the railroad's traffic in order to determine what traffic might be moving at rates which are less than short-run or long-run marginal costs; and (c) scrutinize the assets in the railroad's investment base in an effort to identify those assets which long-run marginal cost analysis indicates have lost all or part of their capacity to earn a fair return. Each of these steps individually is a massive undertaking. Each requires analysis of tremendous amounts of information, most of which is in the exclusive possession of the railroad, and therefore must be sought through the discovery process. In the past, the ICC has refused to compel the railroads to provide much of the information required. In its Coal Rate Guidelines it purports to recognize that extensive discovery will be required, but at the same time it appears to impose requirements of specificity regarding requests which may prove impossible to satisfy.

Once a shipper has completed the management efficiency analysis, as daunting as that undertaking is, it faces an even more difficult task, namely conducting a Ramsey Pricing analysis of the railroad's entire traffic base in an effort to demonstrate that its rate exceeds the "Ramsey optimal rate." In order to conduct this analysis, the shipper must present evidence concerning the demand elasticities of all of the railroad's traffic. The ICC consistently rejected, in the past, the railroads' efforts to impose such a requirement on shippers, because it recognized that total impracticability of such a requirement.

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[36] Ramsey Pricing is a method of differential pricing long advocated by the railroads. Under Ramsey Pricing, each rate contains a mark-up over long run marginal costs in order to cover a portion of what are determined to by "unattributable" costs (in this case, the railroads's revenue shortfall). The unattributable costs are allocated among rail consumers in inverse relation to their demand elasticity. Under Ramsey Pricing, the more captive a shipper is and the less able he is to vary his demand for rail service, the greater the contribution to revenue adequacy he is required to make. In essence, Ramsey Pricing is "what the market will bear" pricing.

The cumulative effect of the burdens associated with an effort to develop a case under the management efficiency constraints is to render it entirely illusory as a remedy. The Commission has constructed an elaborate theoretical system which cannot practically be implemented. Since the shipper bears the burden of proof, the unworkability of the system translates into a guaranteed loss for the shipper and victory for the railroad.

(d) The Phase-In Constraint.

The final constraint under the ICC's Guidelines is that the ICC may require that a rate increase found to be lawful under the stand-alone cost, revenue adequacy, and management inefficiency analyses only be allowed to take effect in stages over some prescribed period of time in order to avoid "severe economic dislocations." The necessity for a phase-in and the type of phase-in which might be required is a matter left for case-by-case determination.

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Viewed in their most favorable light, the ICC's Coal Rate Guidelines fail to provide a meaningful measure of protection for the vast majority of captive rail shippers. The railroads have claimed that the methodology set forth in the Guidelines represents an economically rational way to regulate rates in captive markets, so as to avoid both excessive cross-subsidization and over-restriction of railroad pricing freedom. Their statements elsewhere, however, show that they really believe—ironically, along with the captive coal community—that the Guidelines in effect place no restrictions on a carrier that is considered "revenue inadequate" by the ICC. The only level of pricing prohibited under the law, they say, is monopoly pricing, and "as long as a railroad overall is not earning more than its costs [including the current cost of capital] it is not engaged in monopoly pricing." [37] Simply stated, it is the railroads' position—applicable apparently to all traffic, not just coal—that no individual railroad rate can be considered unreasonable unless the carrier is earning a current cost of capital return on its entire system. While the ICC gives lip service to the contrary, its actions to date indicate at least a general acceptance of this position. We submit this is wholly incompatible with the law.

(e) The Omaha Public Power District Decision.

The Commission has made such in its recent appearances before this Subcommittee and its House counterpart of the decision served on January 15, 1986 in ICC-Docket No. 38783, *Omaha Public Power District* v. *Burlington Northern Railroad Company*, which found a rail rate to be unreasonably high when compared to stand alone costs. Shippers have derived very little comfort from the Omaha Public Power District decision in large part because it is a decision of an Administrative Law Judge, Frederick M. Dolan, Jr., rather than a decision by the full Commission, or a division thereof. There have been a number of other decisions by Administrative Law Judges which constituted "victories" for shippers since the Staggers Act was enacted, but which, due to subsequent appeals and either Commission action or inaction, were never implemented.

The decision in the Omaha Public Power District case has been appeared to the Commission by the Burlington Northern Railroad Company, which filed a 75-page appeal on February 24, 1986 arguing that Judge Dolan's implementation of the stand-alone cost standard is contrary to the basic principles of stand alone costing and inconsistent with the Commission's decision in the Coal Rate Guidelines proceeding in numerous respects. The Eastern and Western Railroads have filed an amicus brief supporting the BN's position. In accordance with the Commission's rules, the effect of the Administrative Law Judge's decision has been stayed by the appeal.

(f) The Consumer Rail Equity Act Will Re-Establish the Balance of Interests Intended By Congress.

The Consumer Rail Equity Act will remedy the fundamental defects in the ICC's unrestrained captive rate methodology by shifting the burden of proof to the party possessing all of the data—the market dominant railroad—and prescribing a set of factors to be considered in determining maximum reasonable rates. Specifically, Section 4 of the Act:

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[37] "AAR's Comments on EEI's 19 Cases of Alleged Railroad Ratemaking Abuses," submitted December 9, 1985 to Subcommittee on Fossil and Synthetic Fuels, U.S. House of Representatives, at 14.

Requires analysis of a carrier's revenue needs, in terms of the extent to which such needs require pricing captive traffic at differential pricing levels in excess of those inherent in the jurisdictional standards of current law;

Requires that the ICC analyze the relationship between a challenged rate and the cost of providing the rail service;

Prohibits the determination of rate reasonableness under the "stand-alone cost" test; and

Ensures that the shipper-protective elements of the Long-Cannon Amendment will be considered in all maximum rate determinations.

Contrary to the railroads 'claims, Section 4 of the Act does not "sever the connection" between maximum rates and revenue adequacy. In fact, it preserves the relationship. It does, however, quite rightly preclude the adoption —de facto or otherwise—of a policy which sanctions any rate level solely on the grounds that the carrier setting it is "revenue inadequate." The standard of Section 4 fully respects the principle of differential pricing. True to the spirit of balance which infused the legislative process in 1980, however, the standard recognizes some clear limits on differential pricing for captive traffic, and acknowledges the time-tested validity of considering the cost of service as one of several elements in a rational ratemaking policy.

3. The ICC Inflation Index

(a) The Problems

An issue of critical concern to both railroads and shippers in the Staggers Act involved the establishment of procedures that would permit the railroads to recoup automatically, through their freight rates, cost increases they incur due to inflation. Prior to the Staggers Act, the railroad industry would periodically come before the ICC in so-called "general rate increase proceedings" and request across-the-board increases in rail freight rates in order to recoup, inter alia, cost increases due to inflation. Given the inflationary spiral which hit the United States in the late 1970's, general increase proceedings became more and more frequent and the costs of processing these cases dramatically increased. Under this system, the railroads were continuously exposed to a regulatory lag between increases in their costs due to inflation and approval of general rate increases to cover such costs.

In the Staggers Act, Congress came up with a method for dealing with the cost inflation/rate pass-through problem. Pursuant to Section 203 of the Staggers Act, the ICC was called upon to devise an index which measured railroad cost increases due to inflation. [38] The railroads are permitted, on a quarterly basis, to increase their freight rates by the percentage change in this ICC index. Because the purpose of these rate increases is merely to offset increases in costs, they are shielded from challenge by shippers.

While the cost recovery rate increase concept is sound, the ICC has adopted an inflation index which overstates the railroads' cost increases. The principal problem with the index—which was promulgated by the ICC in its Ex Parte No. 290 (Sub-No. 2) proceeding [39]—is that it measures only changes in the prices railroads pay for goods and services (input prices), and does not take into account the acknowledged effect of productivity changes on the railroads' cost of producing services (output). [40] For example, if prices paid by the rail industry for fuel increased 20 percent, the ICC's cost index would rise accordingly, even if the industry was moving twice as much freight per gallon of fuel so that actual output costs per unit of output had not risen but fallen.

While the United States Court of Appeals for the D.C. Circuit affirmed the ICC's decision in Ex Parte No. 290 (Sub-No. 2), it noted that the ICC should adopt a productivity adjustment if a valid adjustment could be formulated.[41] On request of rail shippers, on July 26, 1982 the ICC instituted an investigation entitled Ex Parte No. 290 (Sub-No. 4), Railroad Cost Recovery Procedures-Productivity Adjustment. In comments filed on October 25, 1982, shippers provided specific standards for measuring rail productivity and for adjusting the ICC inflation index to properly account for rail productivity changes. Almost two years later, following an August 30, 1984 order from the Court of Appeals for the D.C. Circuit requiring from the ICC a status report on this matter, the ICC issued a "Notice of Proposed Rulemaking" on September 27, 1984. In that notice, the ICC asked for "additional comments," including "comments on whether a productivity should be made at all." Although EEI and other rail shippers again filed extensive comments, at this point another seventeen months have passed and the ICC has taken no further action. Indeed, Chairman Gradison's February 21, 1986 written statement to this Subcommittee merely indicates "[T]he Commission is currently considering the feasibility of adding productivity to the RCAF Formula." In other words, the ICC is still questioning whether a productivity adjustment should be made at all. While the ICC waits, and contemplates, shippers continue to be overcharged because of the ICC's failure to accurately reflect increases in railroad costs.

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[38] 94 Stat. 1901-02.

[39] Ex Parte No. 290 (Sub-No. 2), Railroad Cost Recovery Procedures, 364 I.C.C. 841 (1981).

[40] "Productivity" as used in this discussion simply means the efficiency with which inputs (labor, material, etc.) are used to produce outputs. A productivity increase—*i.e.*, an increase in the amount of output produced by the same inputs, or a reduction in the inputs required to produce the same output, or a combination of the two—can result from a number of different sources, including technological changes, changes in input or output mix, and volume increases.

[41] *Western Coal Traffic League* v. *United States*, 677 F.2d 915 (D.C. Cir.), cert. denied, 459 U.S. 1086 (1982).

Another distinct problem with the ICC's methodology is that it only allows rates to increase. When rail costs go up—so do the rates. But when rail costs go down, no corresponding downward rate adjustments are required. The impact can be very significant. For example, the data filed with the ICC by the AAR on March 5, 1986 for the second quarter 1986 forecast index shows a 4.3% reduction in total costs from the first quarter 1986 estimate. For a $20.00 rate under a rail contract which adjusts the rate upward or downward in accordance with the ICC index, this would occasion an 86 cent rate decrease. For a captive shipper who is paying a $20.00 rate under a tariff, because it lacks the bargaining leverage to obtain a contract on anything other than adhesive terms, however, there would be no decrease in the rate, despite this consequential reduction in the cost index.

Furthermore, the ICC's methodology is based on projections of what costs will be in the coming quarter. If those projections are too high and rail costs subsequently go down or increases do not materialize, there is no mechanism to remedy, for the following quarters, the effects of the excessive projection. On December 20, 1985, the ICC approved a 1.1 percent increase in rates, based in part upon railroad projections that costs for fuel (primarily oil products) would increase 4.9 percent from the actual fourth quarter 1985 level to the first quarter of 1986. This determination was made notwithstanding shipper submissions which showed that the railroad's December 5 filing was based on stale data and that more recent projections anticipated that fuel prices would actually decline, particularly in light of the failure of the December 11 OPEC meeting to reach an agreement on price or marketing strategy. The AAR's March 5, 1986 filing with the ICC now confirms that rather than increasing 4.9%, fuel prices, by February 26, 1986, had decreased approximately 33% from the actual fourth quarter level. It is very clear, therefore, that tariff shippers experienced charges which were based upon an erroneous assumption. The effect of this erroneous assumption will continue due to the failure of the ICC to make downward adjustments in tariff rates when its index declines.

The ICC has not established any mechanism to promptly implement adjustments when, as in the case of fuel in the first quarter of 1986, costs decline. Indeed, Ron Young, Director of the ICC's Bureau of Accounts, accompanying Chairman Gradison at her appearance before the House Subcommittee on Commerce, Transportation and Tourism on February 6, 1986, admitted that there is no mechanism which would allow a captive shipper to recover the excessive fuel costs which it was forced to pay as the result of such an erroneous determination by the ICC. The AAR, in papers filed at the ICC, has taken the position that shippers have no right to comment on the accuracy of the data submitted by the AAR or otherwise to participate in the indexing process.

Since the rail industry is entitled under the law to rate increases to offset rising costs on an "automatic" basis, it is sound and fair policy for there to be a requirement for corresponding decreases in rates when railroad costs go down.

(b) The Consumer Rail Equity Act Solution.

Section 6 of the Consumer Rail Equity Act would quickly and effectively address the problems with the ICC's inflation adjustment mechanism without interfering with the Staggers Act's mandate for prompt, accurate rate adjustments to offset changes in railroad costs. In addition to overcoming the ICC's footdragging by requiring a productivity adjustment to the cost recovery index, Section 6 mandates rate reductions (but only to the extent of prior increases) in those cases where railroad costs—as reflected in the ICC's index—decline.

4. Market dominance

Under the Interstate Commerce Act, the ICC has jurisdiction to determine whether a rail rate is unreasonably high only in those instances where the involved railroad possesses "market dominance" over the transportation to which the rate applies. Under rules adopted in October of 1976,[42] the relevant market for market dominance purposes was defined as the market for transportation services between the origin and destination of the involved traffic, and three fact patterns were established that gave rise to a rebuttable presumption of railroad market dominance.

In the Staggers Act, Congress amended the market dominance provisions by adding a jurisdictional threshold.[43] Under this test, the ICC can now make a finding of market dominance only if the involved railroad rate is set at a revenue/variable-cost ratio greater than a stated percentage, currently 180 percent of variable cost.[44] Significantly, however, the definition of market dominance was left unchanged by the Staggers Act.

Over the universal complaint of shippers, the ICC adopted new market dominance "guidelines" in 1981 which scrapped the prior presumptions and expanded the definition of "relevant market" to include potential geographic and product competitors. Once they went into effect, market dominance proceedings became tortuous exercises involving complex evidence of market definition, market share, etc.[45] Moreover, different decision-makers in the same case (e.g. Review Boards, Divisions of the ICC, the full ICC) frequently reversed one another on market dominance conclusions.[46]

Because of the problems which the ICC's Ex Parte No. 320 (Sub-No. 2) decision was generating, market dominance was placed on the docket for discussion in the ICC's Ex Parte No. 456 proceeding. In this proceeding, the Association of American Railroads ("AAR") and the National Industrial Transportation League ("NITL") adopted a compromise proposal which places the burden on railroads in ICC rate cases to prove that geographic or product competition present effective competition, and provides that evidence of market dominance at an origin point will not be dispositive of market dominance at a destination point and vice versa. This agreement was subsequently considered by the ICC in its Ex Parte No. 320 (Sub-No. 3) proceeding, and on October 31, 1985 a decision approving and adopting the AAR/NITL compromise was served.[47]

Though far from ideal from the shippers' stand[illegible] the AAR/NITL compromise improves the status quo sufficiently to find wary support among captive shippers. As a regulatory pronouncement, however, the Ex Parte No. 320 (Sub-No. 3) decision is subject to the vagaries of changing ICC memberships and railroad positions. To guard against yet another shift (for the worse) in the ICC's guidelines, the essence of the AAR/NITL compromise has been encapsulated in Section 3 of the Consumer Rail Equity Act.

CONGRESS MUST ACT

The electric utility industry supports the fundamental goals of the Staggers Rail Act, and believes that in a great many areas the Staggers Act has worked well and has been implemented by the ICC in such a manner as to carry out the intent of Congress. We wish to make it clear to this Subcommittee that we stand firmly opposed to any effort to "turn back the clock" or otherwise drastically change the reform legislation enacted in 1980.

Despite the many successes, however, there remains one glaring failure under the Act: the ICC's indifference to the plight of captive shippers of bulk commodities, and its accompanying failure to give effect to those provisions of the Act designed by Congress to protect such shippers. Coal users and the consumers they serve have been the principal victims of the Commission's biased interpretations and applications of the law. The ICC's revenue adequacy test and the rate reasonableness considerations employed since the Staggers Act have combined to ensure that not one captive coal shipper has achieved final success in challenging a rail rate.

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[42] Ex Parte No. 320, Special Procedures for Making Findings of Market Dominance as Required by the Railroad Revitalization and Regulatory Reform Act of 1976, 355 I.C.C. 12 (1976).

[43] Staggers Act § 202, 94 Stat. 1900-01.

[44] See 49 U.S.C. § 10709(d).

[45] The text of the 4-R Act makes clear that Congress intended that market dominance regulations "shall be designed to provide for a practical determination [of market dominance] without administrative delay." 4-R Act 202(a). Similarly, the Senate Commerce Committee observed: Lengthy antitrust-type litigation will be avoided by virtue of the Commission's authority to adopt rules of practical application which will identify markets in which dominance exists.

S. Rep. No. 94-499, 94th Cong., 1st Sess. 47 (1975).

[46] EEI presented a comprehensive review of these problems in its November 5, 1984 filing in Ex Parte No. 456, The Staggers Rail Act of 1980—Conference of Interested Parties.

[47] Ex Parte No. 320 (Sub-No. 3), Product and Geographic Competition, Decision served October 31, 1985.

The evidence makes it clear that neither Congress nor captive shippers can afford to "wait and see" any longer. While a comprehensive overhaul of the Staggers Act is neither required nor desirable, there remains no alternative but legislative action to ensure future enforcement of captive shipper protections, and to achieve the balanced approach to railroad rate regulation which Congress so clearly mandated in 1980.

To accomplish this goal, we strongly urge action by this Subcommittee and the Congress to enact S. 477, the Consumer Rail Equity Act, and rectify the misguided manner in which the Interstate Commerce Commission has implemented the Staggers Rail Act captive shipper protections.

We appreciate the opportunity to present the position of the Edison Electric Institute on this important consumer issue before the Subcommittee.

STATEMENT OF WILLIAM H. DEMPSEY

The February 21, 1986 testimony of William H. Dempsey for the Association of American Railroads (AAR) challenged the validity of EEI's analyses of the profitability of tariffs for movements of coal to 19 captive utilities and of the profitability of coal relative to other commodities. The EEI analyses showed that the pre-tax returns on investment to the railroads inherent in coal tariffs to 19 captive utilities ranged from a low of 51% to a high of 157%. EEI also concluded that coal had the highest operating margin of profit of any commodity carried by the railroads. AAR's challenges are based primarily upon an analysis which the ICC Bureau of Accounts released at the November, 1985 hearings before this Subcommittee and updated in January, 1986 and upon a critique submitted as Attachment 2 to Mr. Dempsey's statement to this Subcommittee.

The ICC/AAR criticisms are wrong. The ICC's primary criticism of the EEI return on investment analysis is that it is "based on EEI's notion of revenue adequacy which...is conceptually flawed." By this, the ICC apparently refers to the fact that EEI computed return on investment with reference to the actual value of the investments necessary for each movement, rather than to the current cost of replacing those investments. No other industry measures return on investment as the ICC describes. Moreover, Chairman Gradison's own testimony before this Subcommittee on February 21 acknowledges that the ICC's revenue adequacy standards "are not producing a realistic picture of the financial condition of the rail industry." We submit that it is the ICC's approach, not that adopted by EEI, which is conceptually flawed.

The ICC's complaint that EEI's return on investment analysis of specific movements does not use actual data describing costs imposes an unrealistic demand for data that railroads and the ICC do not make available (outside rate cases). EEI used data from ICC, ALJ and state commission decisions, to the extent available; when such data was not available, EEI used information provided by utility cost consultants in individual rate cases wherever possible. The costs applied by EEI were determined by procedures that are universally used and that have been accepted by the ICC in countless ratemaking proceedings.

The criticisms of the return on investment analysis in AAR's Attachment 2 to its February 21 statement also impose unrealistic data demands. First, EEI used 1982 data for operational, traffic, cost and investment characteristics because at the time the EEI analysis was performed, 1982 data was the latest available. AAR provides no basis to indicate that railroad operations, traffic, cost or investment characteristics have changed materially since then.

Second, EEI's use of adjusted average data when actual data was not available did not underestimate costs. While AAR correctly points out that high density main lines require higher than average total investment, the actual investment per ton is lower than the system average. System average figures include items, such as Trailer On Flat Car facilities, that do not apply to unit train operations.

Third, EEI properly escalated prior years' costs by reference to either the escalation methodology actually used by the railroad for the specific movement or the Rail Cost Adjustment Factor, which railroads apply to compensate for increasing costs of operation. Such an approach clearly does not warrant characterization as a "meat-ax approximation."

With respect to the reliability of AAR's statements about individual rates, we simply note that AAR repeats the claim that the Omaha Public Power District rate analyzed by EEI "has not been contested." Yet this is the very rate to Omaha Public Power District for which an ICC ALJ recently issued a decision under the ICC's new coal rate guidelines and which has received much publicity from the Commission.

In addition to analyzing the return on investment inherent in the 19 movements to individual utilities, EEI also analyzed the "operating profit" inherent from these movements. Return on investment was determined separately from operating profit and in a manner which took into account all railroad costs, including fixed costs. Operating profit, on the other hand, was determined with reference to the ICC definition of variable cost, which includes a portion of what in other industries would be considered fixed cost. The term "operating profit" therefore was chosen as being most descriptive. EEI did not represent these figures as a total profit analysis.

With respect to the relative profitability of coal in general, the ICC agrees with EEI that the cost of moving coal is the lowest of all commodities on a ton-mile basis. The ICC's January, 1986 analysis also shows in Table 2 that the ratio of revenue to variable cost for coal in 1983 was the fourth highest of the commodities studied and is considerably above the average for all commodities. No explanation is given why the ICC's January, 1986 analysis appears to reach different conclusions, particularly for 1983, from the November, 1985 analysis which was previously submitted to this Subcommittee. Only when profitability per ton is measured on a cents per ton basis does the ICC analysis support its conclusion (repeated by AAR) that "coal's profitability is . . . the average of all commodities." In other words, the ICC and AAR have chosen to describe the profitability of coal in terms which are most likely to appear to understate its importance to the railroads.

More importantly, ICC and EEI disagree exactly how costs should be determined, particularly with respect to the fact that most coal is carried in highly efficient unit trains. The data reported to the ICC requires adjustments to account for unit train efficiencies, and EEI applied adjustments commonly accepted in rate cases before the ICC. While the ICC's critique involves extremely technical issues, which often requires a detailed understanding of ICC costing methodology, our disagreement with some of their criticisms is easily understood. For example, the ICC's recommended procedures would allow for 12.5 hours of switching at origin or destination when, in reality, trains are frequently switched and unloaded in 4 hours or less. EEI's adjustment took this reality into account. ICC also criticized EEI's use of the Costed Waybill Sample adjusted by the Freight Commodity Statistics, even though the AAR has admitted the need to adjust the Costed Waybill Sample in the same manner as EEI found necessary. See AAR's March 28, 1985 filing in Ex Parte No. 290 (Sub No-4).

Ultimately, there is no dispute about the importance of profits from coal to the railroads. AAR states that coal accounts for 40 percent of all rail traffic. Since the passage of the Staggers Act, coal has accounted for increasingly larger shares of rail traffic. Even if the ICC's profitability analysis were correct, the fact that much more coal is transported by rail and at a lower cost per ton-mile than any other commodity still would strongly suggest that the overall profitability of coal to the railroads is considerable.

STATEMENT OF THE NORTH DAKOTA WHEAT COMMISSION

THE INTERSTATE COMMERCE COMMISSION AND RAIL REGULATION

The North Dakota State Wheat Commission is a quasi-state agency charged with the responsibility of promoting greater market development for North Dakota wheat. The Wheat Commission is financed by the farmers in our state through a voluntary tax on each bushel of wheat sold. The Wheat Commission has, in the past, been involved in numerous Interstate Commerce Commission cases, rule-making proceedings and hearings.

Today, the North Dakota Wheat Commission finds itself in the unusual position of defending the Interstate Commerce Commission. In recent years we have not been happy with the Commission's actions. Particularly disappointing has been the Commission's interpretation and implementation of the Staggers Rail Act. Despite our concerns about the current activities of the ICC, the North Dakota Wheat Commission believes that the ICC absolutely should not be abolished. While it has not done its job well during the last few years, the remedy is not to abolish the ICC, but rather to specifically direct the ICC to implement the Staggers Rail Act in a way envisioned by the creators of that Act.

North Dakota is dependent on its agricultural industry. The economy of North Dakota revolves around agricultural production. Effective transportation of agricultural commodities is essential to the economic viability of our state. Monopoly transportation practices could be ruinous to North Dakota's economy.

Unfortunately, we are a landlocked state. The agricultural goods we produce must generally be shipped long distances. In the past, trucks have not provided adequate competition for North Dakota's railroads. Similarly, neither the Burlington Northern Railroad nor the Soo Line Railroad, the two railroads which serve North Dakota, have shown an inclination to compete against each other. North Dakota wheat, barley, sunflower and corn rates have, in the past, consistently been some of the highest, most profitable rates charged on any commodity moved by the railroads.

It has only been within the last couple of years that we have seen our rates stabilize and rail service improve.

The North Dakota Wheat Commission is not so naive as to think the situation could not reverse itself in the future. When the car supply tightens up, North Dakota expects the railroads to increase their freight rates. Similarly, this state will in the future, as it has in the past, be one of the first to experience the adverse effect of rail car shortages. Railroads must compete in areas where they face competition. Their market dominance in the state of North Dakota allows them to take care of shippers in other states first and worry about North Dakota later.

North Dakota shippers are rail captive. This is particularly true as to the hundreds of small grain elevators which dot our state and which are served by only one railroad. These elevators are the foundation for the agricultural enterprise in our state. The elevators purchase the farmers' grain and sell the grain either for export to other countries or for domestic processing and consumption. It is necessary for these elevators to transfer the grain great distances to the ultimate export facility or to the domestic miller, brewer or processor. Under the grain marketing system, the transportation charges are borne by the farmer. When elevators are exploited by high freight charges or discriminated against in the area of rates or service, it is the North Dakota farmer who suffers.

One very disturbing aspect of the current transportation picture in North Dakota is that rail dominance is increasing. During the 1984–85 crop year, 521 million bushels of grain and oilseed were shipped out of this state. Over 73 percent of all agricultural shipments out of the state of North Dakota were by rail. Last year, rail movements accounted for 71 percent of all hard red spring wheat shipments, 84 percent of durum shipments, 83 percent of barley shipments, 63 percent of sunflower shipments, and 83 percent of corn shipments.

It is frightening to think that at the same time North Dakota becomes more and more captive to two railroads, there are plans to abolish the Interstate Commerce Commission.

Even though we have not been satisfied with the ICC's performance during the past few years, its mere existence has had a positive effect. As long as the threat or the possibility of ICC action exists, the railroads are compelled to demonstrate some restraint in dealing with shippers.

It has not been that many years since the ICC was much more than what it is today. In the past, the Commission actively protected small shippers from rail exploitation. The need and the public support for such positive action in the future could very easily occur as the huge national railroads gain more and more market power. If the ICC is abolished, it would be an extremely difficult and lengthy process to reinvent it.

The North Dakota Wheat Commission supports legislative efforts to amend the Staggers Rail Act. We are particularly supportive of proposed changes designed to protect captive shippers, require railroads to charge reasonable rates, provide competitive service, and prohibit abandonment of necessary rail lines. It is not time to bury the Interstate Commerce Commission. It is time to direct the Commission to do its job.

STATEMENT OF THE NORTH DAKOTA PUBLIC SERVICE COMMISSION

The North Dakota Public Service Commission (NDPSC) is a constitutional agency of the State of North Dakota. Its responsibilities include regulating intrastate rail activities and representing state transportation interests before Congress and federal agencies such as the Interstate Commerce Commission (ICC).

The NDPSC's involvement with railroads dates back to territorial days. In 1885 the Dakota Territory established the Board of Railroad Commissioners to regulate railroads and represent state shipping interests. These responsibilities were carried forward when North Dakota was made a state in 1889 and when the Board of Railroad Commissioners became the Public Service Commission in 1940.

North Dakota's interest and involvement in transportation stems from its agricultural background and its geographic location. North Dakota is one of the nation's leading producers of grain. Each year the state's farmers market over 550 million bushels of wheat, barley, oats, corn and sunflower for consumption outside the state.

North Dakota is located in the middle of the North American continent. Its closest major grain market is located over 200 miles from the nearest North Dakota point; it is over 500 miles from western North Dakota to this market. Other major markets are more than 1000 miles away. These production, consumption and locational factors make transportation an issue of vital importance to the state.

The availability of transportation services and applicable rate levels have been relatively satisfactory since 1980. Compared to certain periods in the 1970's, for example, current conditions are more desirable. The Staggers Act cannot, however, be credited with all these improvements. More importantly, current conditions may not be a true indicator of the future.

The 1980's have been an economic disaster for agriculture. Declining export demands for wheat and steady or increasing supplies have caused market prices to drop. A related occurrence has been a decline in demand for rail grain transportation services and predictably a drop in rates. The 1980's have proven that rail deregulation works in a down economy. This is not to say, however, that all is well and just relative to North Dakota rail grain transportation.

On the national level grain is typically shipped to market by truck, rail or barge. Because of the bulky nature of grain and the cost characteristics of the trucking industry, trucks are a competitive force only when the shipment involved moves 250 miles or less. Trucks occasionally transport grain over 250 miles but such as occurrence is usually indicative of a backhaul situation. Because of North Dakota's location relative to grain markets trucks have a difficult time competing for movements of North Dakota grain.

The only other feasible non-rail means of transporting grain is by water. North Dakota does not, however, have any navigable waterways within 200 miles of its borders. The western border of the state is over 500 miles away from the nearest navigable waterway. Water transportation is not a direct competitive force relative to movements of North Dakota grain.

As this discussion indicates, railroads have little effective intermodal competition in North Dakota What competition does exist affects only those movements destined for nearby markets. The railroads' strength is illustrated by the fact that 72 percent of the 1.55 billion bushels of grain shipped by North Dakotans in the past three years was shipped by rail. For the twelve month period ending June 30, 1985, over 80 percent of the grain destined for out-of-state points was moved by rail.

It may be argued that the "reasonable" level of railroad rates has allowed the railroads to capture such a large share of the market. Two brief illustrations will show, however, that North Dakota's rail rates are not reasonable compared to those in other areas.

Lewiston, Idaho, is at the head of the Columbia River system. Barges operate between Lewiston and Portland, Oregon. It is just over 500 rail miles from Lewiston to Portland. Portland is a major export point for wheat. The rail rate on wheat between the two points is approximately 54 cents per one hundred pounds.

In comparison, it is just under 500 rail miles from Minot, North Dakota, to Duluth, Minnesota. Minot is a major shipper of wheat, must of which is destined for the export point of Duluth. Two rail carriers operate between the two cities and "compete" for the traffic. The current rate on wheat moving between Minot and Duluth is approximately $1.27 per one hundred pounds. The absence of effective competition results in a rate that is 235 percent of the rate in effect in the Lewiston to Portland corridor.

A similar situation exists relative to movements of wheat moving from North Dakota and Nebraska to Portland. Nebraska wheat can be positioned for export either by being railed to Portland or by being barged down the Missouri and Mississippi Rivers to New Orleans. The existence of barge competition has caused the railroads to charge $1.47 per one hundred pounds to move a trainload of wheat from Alliance, Nebraska, to Portland, Oregon. It is 1464 rail miles between the two cities.

Conversely, there are two railroads that transport wheat between Devils Lake, North Dakota, and Portland, a distance of 1431 rail miles. The rail rate on a trainload of wheat moving between the two points is $1.84 per one hundred pounds, 25 percent more than the Nebraska shipment described above.

These examples illustrate that truck and intramodal rail competition are not as effective as barge competition in influencing railroad pricing practices. The relative ineffectiveness of truck and intramodal rail competition means that North Dakota shippers are eternally destined to pay higher freight rates than their more fortunate counterparts in other parts of the country. This reality directly affects North Dakota grain prices, farm income and land values.

North Dakotans do not appreciate but none-the-less must pay higher than average freight rates. This is the case as it exists in today's depressed farm and transportation economies.

It is important to remember, however, that the agricultural economy will improve. Demand for grain will increase and prices will rise. Relatedly, demands for transportation services will increase, rail car supplies will cease to show a surplus, and rail rates will rise. It is obvious to North Dakota that railroads will increase rates most in situations where competition is most lacking; it will come in captive environments such as North Dakota. The freight rate differential that currently exists between North Dakota and other producing regions will widen. North Dakota, because of a lack of competition in its transportation industry, will not participate to the full extent in any resurgence that eventually comes to the agricultural community. The impacts will be and are being felt by every man, woman and child in the state.

The reality of the situation is that rail freight rates, could double, triple or quadruple tomorrow and "captive" agricultural shippers would have no effective means of seeking relief. A complaint could be filed with the ICC but such an effort would be pointless. Under the ICC's guidelines, virtually any level of rates is reasonable if the railroad involved is not "revenue adequate." utilizing the ICC's standards there is not a single revenue adequate railroad in the country. It is doubtful that any carrier will ever be found "revenue adequate" because of the way that the ICC's formula is structured. It is therefore highly unlikely that any agricultural shipper, regardless of its situation, will ever have the ICC rule in its favor in a rate complaint case. The ICC has in effect decided that effective competition is a universal occurrence and that no governmental involvement is necessary to protect any segment of the shipping public.

The ICC's eagerness to bring financial health to the rail industry has unfortunately kept it from encouraging intermodal and intramodal competition and from implementing workable procedures to provide captive shippers with a means of seeking relief from monopolistic railroad practices.

Intramodal rail competition has been drastically diminished since 1980. Railroads are merging at a race horse pace. In 1984 the nation's seven largest railroads generated over 83 percent of all the revenues earned by the country's Class I roads. There has been a wholesale cancellation of rates governing movements originated by one carrier and delivered by another. The rates charged for switching railcars from one carrier's lines to those of another have in many cases skyrocketed to prohibitive levels. Rail shippers have fewer shipping options available today than they did five years ago. The nation's rail "system" is deteriorating.

All of these anti-competitive occurrences have come about under the jurisdictional eye of the ICC. It is obvious that the ICC is interested in pursuing only some of the goals propounded by the Staggers Act; namely enhancing the financial viability of the railroad industry and depending on competitive forces in the marketplace to regulate railroad activities and rates. Effective competition is not, unfortunately, a universal occurrence.

The ICC has been blatantly remiss in fulfilling its statutory duties relative to the protective assurances of the Act. The Commission has done nothing to create or encourage effective intermodal and intramodal competition relative to the rail industry. Similarly, the Commission has failed to implement workable guidelines to protect "captive" shippers that must function in a non-competitive environment. These interests are left unprotected by either the marketplace or the ICC.

The ICC may argue that it has implemented rules regarding market dominance, revenue adequacy and competitive access. The fact remains, however, that many of these rules provide only the appearance of genuine protection. In reality captive shippers remain unprotected.

In a few instances the ICC has adopted rules that may provide a degree of recourse for aggrieved shippers. Unfortunately, these rules provide for settlements only on a case-by-case review of the situation and require a staff of attorneys to process the case on behalf of the shipper. The cost of pursuing justice in such a system makes justice unattainable for small shippers.

In July of 1985 the NDPSC and others filed a petition with the ICC asking that a rulemaking proceeding be initiated. The intent of the proceeding was to implement rules that might lead to an increase in competition between railroads. As of January the ICC had not responded to the request. It was legally required to do so within 180 days. Their "response" to this pro-competitive request is indicative of the type of treatment captive shippers now get and can expect in the future from the ICC. This situation can be rectified only with statutory changes such as those suggested in the bill draft before you.

The NDPSC is not totally negative regarding the Staggers Act. The first half of this decade has proven that the Act has worked where competition exists. Competition is not, however, a universal occurrence. The ICC's administration of the Act has unfortunately done little to encourage or create competition in the rail industry. The ICC has also neglected to take steps to implement workable guidelines to provide meaningful protection to captive shippers, many of which are small and without traffic managers and legal counsel skilled in transportation matters.

The NDPSC does not believe that the current situation reflects the intent of Congress when it passed the Staggers Rail Act in 1980. Five years is more than enough time to have enacted rules to implement the protective goals of the Act. The ICC has failed to do so. It is time for Congress to act. The NDPSC supports the philosophies propounded by S. 477.

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION

The American Farm Bureau Federation is the nation's largest general farm organization with a membership exceeding three million families in 49 states and Puerto Rico who are members of 2,762 County Farm Bureaus.

Agriculture, as does the nation as a whole, needs an efficient, sound, healthy railroad system. A railroad freight service policy for the movement of agricultural commodities would not only serve the best interests of the farmer, but would also benefit the entire economy.

Farm Bureau recently adopted a railroad policy that rejects the concept of nationalization; recommends that Conrail be returned to the private sector; gives greater ratemaking flexibility to rail carriers to permit more competitive operations, but retains sufficient authority to protect captive shippers against monopoly pricing; eliminates discriminatory railroad rates between geographic areas of the country and opposes parallel mergers of rail systems and the granting of railroad abandonments, which tend to lessen overall transportation competition.

Agriculture has a strong interest in maintaining the long-term efficiency of the railroad system. Railroads are a vital link in the transportation system for agricultural supplies and the marketing of agricultural products. The nation's freight railroads carried 4.8 billion bushels of grain in 1984, making it the second biggest grain hauling year for the rail industry. While railroads are important to agriculture, agriculture is also important to the railroads, because we are one of their best customers.

Farm Bureau supported the enactment of the Staggers Rail Act in 1980 because we believed it carefully balanced the interests of the railroads and the interests of the shipping public and agriculture. The greater discretion in ratemaking accorded the railroads was in large part based upon the expectation that carrier competition, more specifically, competition among and between the railroads themselves, would preserve and strengthen railroad services.

There are indications that the rail industry has endured the current recession better than other industries, and that the Staggers Act will be a tremendous help when rail traffic picks up even more in the years ahead. One example is the success of Conrail which has been profitable for the past two years and is now an attractive investment for private rail operators, as well as other investors.

Although the system under Staggers is fairly new, and because of the recent recession a little too early to observe significant impacts from an agricultural point of view, we believe the system works and that the railroads are once again financially viable and back on the competitive track. The simple fact is that the farmer's products are being moved quicker, better and for the most part cheaper. However, this does not imply there are not some problems with the implementation of Staggers. We cannot move from almost 100 years of strict economic regulation to a less deregulated environment without some difficulty.

Dissatisfaction among some agricultural shippers has been voiced about as to how the law is being carried out and administered by the Interstate Commerce Commission. Many shippers believe the Staggers Act has not achieved the objective that Congress had hoped for when it passed the Act and that some key modifications are necessary.

CAPTIVE SHIPPERS AND RAIL MARKET DOMINANCE

Prior to the Staggers Act, the ICC was responsible for seeing that rail rates were reasonable and non-discriminatory among a railroad's shippers, among competing locations served by a railroad, and among competing commodities carried by a railroad. Under the Staggers Act, a railroad may establish any rate it wishes, with the following exceptions: (1) A rate on traffic over which the railroad has market dominance must be reasonable; (2) No rail rate may be below a reasonable minimum; and (3) A rate must not be prohibitive by any specific provision of federal law regulating rail rates.

The ICC's implementation of the Staggers Act has been sharply criticized by some shippers who believe that their traffic is "captive" to railroads because no viable transportation alternative is available at a price they can afford to pay. This idea is also expressed as "rail market dominance."

Farm Bureau favors legislation giving greater ratemaking flexibility to rail carriers to permit more competitive operations. However, we believe sufficient regulatory authority must be retained to protect captive shippers against monopoly pricing. We support the elimination of discriminatory railroad rates between geographic areas of the country. We ask that rates be based on weight, volume and distance on a uniform basis for all regions of the country.

To improve the problem in regard to "captive shipper" and "market dominance," the ICC should develop clear, precise definitions of these terms that recognize the realities of rail transportation. Shippers can seek administrative and judicial protection or relief only with legal standing provided by proper definitions.

JOINT RATES AND THROUGH ROUTES

For many years some railroads, most notably Conrail, argued that they were severely disadvantaged by the portion of revenues they received on traffic shared with other carriers. Rates on interline traffic when billed on a single bill of lading are called "joint rates," and the routes are called "through routes." The Staggers Act has allowed the railroads to increase their revenues on such traffic.

The Act also made it easier for a railroad to stop serving more than one route between two points. Some shippers argue that ICC implementation of these provisions of the Staggers Act, the so-called competitive access, has reduced their transportation options and raised their freight rates. Some railroads argue that they are harmed when one of their interlining rail carriers closes one or more of these routes or raises the joint rate.

An integrated rail transportation system is essential to the efficient movement of agricultural commodities. Grain farmers and shippers need the ability to market their commodities, for both export and domestic purposes, unimpeded by artificial barriers that have been erected by rail carriers. Under the Staggers Rail Act, artificial barriers in the form of canceled rates for through routes do not provide for increased competition in the transportation marketplace. On the contrary, canceled rates for through routes lessen competition by restricting certain carrier participation in specific markets and by limiting the choice a shipper has in getting his commodity to market.

Under the manner in which the ICC is interpreting the Staggers Act, joint rates and routes can be canceled by carriers without opposition from the ICC. This amounts to forced deregulation and restraint of trade by limiting a shipper's access to markets which could be served via a joint route.

Farm Bureau believes there should be some refinement of the Staggers Act to provide reasonable joint rates and switching agreements in order to promote the efficient transportation of commodities among different rail service areas. We believe reciprocal switching should be available at all locations served by more than one carrier at fees based upon the actual cost of performing the service. Railroads should not be allowed to levy arbitrary switching fees that in effect restrict shippers to the use of specific rail lines.

CONTRACTS

Contracts have been generally well received by shippers and the railroads. Both claim that contracts make planning easier, permitting railroads to gauge their investments and provide shippers with more dependable service and prices less subject to change. The major complaint concerning contracts is that not enough information is filed or made available to the public.

Farm Bureau believes that information with respect to rail rates should be made available to the marketplace. The ICC's implementation of the Staggers Rail Act does not permit full disclosure of all economic terms included in rail grain contracts and is contrary to the intent of Staggers. We believe some modification of the Act should be made to provide for the full disclosure of all economic terms of rail grain contracts as Congress intended when it passed the Staggers Rail Act. Improved reporting through full disclosure of contract rates would improve shippers' ability to make intelligence assessments of shipping costs. It would also provide shippers information that is regularly available to them about shipping costs on other modes of transportation.

Farm Bureau has not joined any shipper organization or coalition that seeks to change the Staggers Rail Act. We do not support S. 477, the Consumer Rail Equity Act, because our policy calls for the Interstate Commerce Commission to continue efforts to deregulate the railroads. Considering the healthier and more productive environment brought about by the Staggers Rail Act, we see no good reason to reregulate railroads which the Consumers Rail Equity Act is designed to accomplish.

The Staggers Act has improved the efficiency and reliability of shipping goods by rail. Railroads have once again become financially sound and this has enabled the rail industry to provide improved grain handling service in most areas of the United States, with enhanced port capacities, unit trains and other improvements that are in the best interest of agriculture.

As mentioned previously, there have been some problems with the implementation of Staggers. We have tried to identify the justifiable concerns of agricultural shippers without proposing legislative remedies. One of the benefits of reduced regulation is the ability of railroads and their customers to discuss problems and negotiate settlements without the need to reregulate the railroad industry. Since the enactment of Staggers, the industry has seen the need to reduce its cost structure, followed by rate reductions, while providing substantially improved service in its efforts to remain economically viable. This would not appear to be the time to amend the Staggers Act and attempt to reregulate the rail industry.

EDISON ELECTRIC INSTITUTE,
Washington, DC, February 21, 1986.

Hon. RUSSELL LONG,
U.S. Senate,
Washington, DC.

DEAR SENATOR LONG: On behalf of the Edison Electric Institute, I am writing to thank you for your support of the Consumer Rail Equity Act, S. 477. We deeply appreciate your cosponsorship and strong advocacy of this important legislation.

EEI is the association of electric companies. Our members serve 96 percent of all customers served by the investor-owned segment of the industry, and service 73 percent of all ultimate customers in the nation. Many of our members are captive shippers of coal and, as such, are deeply concerned about the Interstate Commerce Commission's (ICC) implementation of the Staggers Rail Act.

As you well know, the Staggers Rail Act deregulated competitive rail traffic, but largely through your efforts, recognized the need to continue to protect consumers and shippers captive to a single railroad. However, the ICC has effectively evaded implementing the congressional mandate to assure the reasonableness of rates where no effective competition exists.

This is cause for deep concern by utilities and our customers. In 1984, utilities purchased over 700 million tons of coal. Of this coal, a substantial portion is captive to delivery by a single railroad and susceptible to monopoly power in the form of excessive rail rates. Electric utilities currently incur approximately $5.5 billion in rail freight charges each year. These costs are passed through to our customers and are reflected in the rates they pay for electricity. Utilities earn no profits on these transportation costs.

The ICC's actions in several rulemaking proceedings demonstrate the need for corrective legislative action:

The ICC standards for determining whether or not a railroad is revenue adequate grossly overstate a railroad's revenue needs, and are inconsistent with standards commonly applied by utility regulatory commissions. Under these ICC standards, not a single major railroad is considered revenue adequate. As a result, they are afforded substantial ratemaking freedoms at the expense of captive shippers.

The ICC has issued guidelines for determining maximum reasonable rates on coal that permit a "revenue inadequate" railroad to set any rate it chooses unless a shipper can prove the rate is unreasonable through complex, expensive and lengthy presentations under a set of nebulous constraints. The central element of these constraints is stand-alone cost, a concept which allows a railroad to charge as much as it would cost a shipper or group of shippers to build and operate its own railroad or other transportation system. The shippers bear the substantial burden of proving that a rate is unreasonable.

The ICC has established a mechanism to increase rail rates to account for changes in the railroads 'costs of providing service which ignores the effect of improvements in railroad productivity, and fails to afford rate decreases when corresponding service costs decline.

EEI supports the Consumer Rail Equity Act which would require adoption of a test for railroad revenue adequacy that uses generally accepted regulatory commission practices to produce an accurate measure of a railroad's financial health; fairly allocate burdens of proof between shippers and railroads; require adoption of a fair, workable and realistic rate reasonableness standard for captive shipper rates; and provide a mechanism for cost recovery rate adjustments that reflects changes in railroad productivity and implements reductions in rail rates when rail costs decline.

The Consumer Rail Equity Act is not re-regulation. It would retain the existing limits on ICC jurisdiction and continue current policy that all contract rates and rates for competitive traffic are deregulated. However, it would help to assure captive shippers of the protections originally intended by the Staggers Rail Act.

We believe that the hearings currently underway before the Surface Transportation Subcommittee will show clearly the need for a legislative remedy to the problems facing captive shippers. We appreciate this opportunity to bring these problems to the Subcommittee's attention, and ask that this letter be included in the hearing record.

Sincerely,

THOMAS R. KUHN.

HOW MAJOR ORGANIZATIONS VIEW THE ICC'S IMPLEMENTATION OF THE STAGGERS ACT

Excerpts from Testimony and Statements Submitted to the Subcommittee on Surface Transportation of the Senate Committee on Commerce, Science and Transportation, November, 1985:

RAILROADS AGAINST MONOPOLY

"The Commission thus has effectively ignored the remedy provided by Congress, 'abandoned its former policy' with respect to cancellation of joint rates, and 'now routinely allows such tarrifs to go into effect.'

"* * * the Commission simply has not been giving adequate attention to what the Congress provided as guidelines for solving problems related to joint rates and joint rate cancellations. Even though the courts have uniformly criticized the Commission for its lack of attention to legislative intent, the Commission has not in any significant way thus far changed its attitudes or holdings."

Testimony of Harold L. Gastler on behalf of Katy Railroad and Railroads Against Monopoly.

NATIONAL GRAIN AND FEED ASSOCIATION

"But one fact has become increasingly clear. Namely, that competitive alternatives for rail shippers are becoming increasingly vulnerable to the actions and decisions of the rail industry in our present deregulated environment, and the opportunity for redress before the Interstate Commerce Commission continues to diminish.

"The grain industry has been particularly hard-hit by the closure of joint rates and routes and the cancellation or increased cost of switching agreement * * *.

"We believe that competition, both intra and intermodal, should be a basic right of shippers, and where necessary, regulatory relief should be available and relatively simple to pursue. Agricultural and other shippers have been frustrated in attempts to pursue regulatory relief before the ICC. To encourage effective intramodal competition, the National Grain and Feed Association believes that amending legislation may be necessary to define more precisely the intent of Congress."

Testimony of William C. Harding on behalf of the National Grain and Feed Association.

PROCOMPETITIVE RAIL STEERING COMMITTEE

"Since enactment of the Staggers Rail Act to the present time the members of the Procompetitive Committee have been shocked and chagrined at the indifference of the Interstate Commerce Commission to the subject of rail-to-rail competition, as the Agency proceeded to implement the Staggers Rail Act.

"* * * the Procompetitive Committee stands steadfast in its conviction that rail-to-rail competition is crucial and that Congress should leave no doubt of its desire that rail-to-rail competition, under the Staggers Rail Act, should be preserved, promoted and strengthened. It is the further conviction of the Procompetitive Committee that this vital subject cannot be left to the discretion or to the whim of the Interstate Commerce Commission * * *.

"At this stage, in testifying in these Staggers Rail Act oversight hearings, the Procompetitive Committee supports in principle the concepts embodied in Section 7 of S. 477, the C.U.R.E. bill."

Testimony of Michael E. Petruccelli on behalf of the Procompetitive Rail Steering Committee.

"Let the railroads with their power base say what they want but the facts are that they, the railroads, are not meeting the intent of Congress when it passed the Staggers Act * * *. We as an industry support the efforts of C.U.R.E. but feel they may not be going far enough with their efforts * * *.

"We feel that changes are needed to allow a more competitive approach that will allow us access to a transportation system that will meet the needs of the shipper. The ICC and its interpretation of the Staggers Act will not and cannot solve our problems and the railroads, of course, will not solve it. Our only chance in solving the Staggers Act problems is for Congress to act and act quickly. Congress created the Staggers Act and only Congress can correct it."

Michael E. Burrill, Chairman of Eugene F. Burrill Lumber Company of Medford, Oregon Testifying on Behalf of Northwest Timber Shippers.

"The Staggers Act is not a perfect law and it certainly is not being perfectly applied. It is now time for the Congress to take a hard look at this law and its application to make sure that its will is being executed; and if it finds it is not, it should enact amendatory legislation to compel compliance.

"We are submitting for the record along with this statement a 'Statement of the Railway Labor Executives' Association on Staggers Rail Act Oversight' which details * * * Congress 'extensive protection of employee interests in Staggers and the present Commission's defiance of that tradition by the blatant arrogation to itself of policy determinations restricted to the Congress by the Constitution."

Statement Submitted by James R. Snyder on behalf of Railway Labor Executives 'Association.

"We supported the Staggers Act * * *. Now because of inappropriate decisions by the Interstate Commerce Commission * * * we have serious concerns about the treatment of coal producers, sellers, consumers and shippers * * * we believe the time is ripe for legislation needed to preserve the goals of the Staggers Act. Accordingly, NCA supports passage of the Consumer Rail Equity Act now before the Congress.

Donald P. Bellum President of Cyprus Coal Company, testifying on behalf of the National Coal Association.

"Our member groups regularly participate in proceedings at the federal and state levels, as have I on numerous occasions. We win some cases and we lose some, but above all, we have a sense that the process is reasonable—that the rules are impartial and the deliberative bodies are engaged in a good faith effort to balance the needs of consumers and the providers of monopoly services.

That simply is not the case with the ICC's implementation of the captive shipper provisions of the Staggers Act. The scales have been so tilted in favor of the railroads and the burden placed on complainants so onerous, that we despair of getting a fair hearing or achieving a sensible result.

All we are asking Congress to do is to ensure an equitable set of rules applied by a reasonably impartial body and we will take our chances on the process * * *.

The solution we are proposing to the Committee (the Consumer Rail Equity Act, S. 477) is essentially a matter of procedural fairness."

Testimony of Dr. Mark N. Cooper on behalf of the Consumer Federation of America.

"For most rural cooperatives and the consumers they serve, the Interstate Commerce Commission represents the only potential source of protection from market power abuse in those circumstances where competitive alternatives are not available. The Commission, however, has totally ignored the balance of shipper and carrier interests incorporated into the Staggers Rail Act of 1980, and has permitted the establishment and maintenance of exploitive rail rates and service conditions with respect to coal and other captive shippers. It is for this reason that NRECA vigorously urges Congressional enactment of S. 477, the Consumer Rail Equity Act, to correct the Commission's misguided approach to regulation under the Interstate Commerce Act."

Testimony of J.B. Flanders, General Manager of the Arizona Electric Power Cooperative, on behalf of the National Rural Electric Cooperative Association

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LOUISIANA PUBLIC SERVICE COMMISSION,
Baton Rouge, LA, February 18, 1986.

Hon. RUSSELL B. LONG,
U.S. Senate, Senate Office Building, Washington, DC.

DEAR SENATOR LONG: It is our understanding that a Subcommittee will conduct a hearing in the near future on S. 477, the Consumer Rail Equity Act. The Louisiana Public Service Commission has been supportive of the efforts of the Consumers United For Rail Equity, and the National Association of Regulatory Utility Commissioners in sponsoring or supporting legislation to provide for consumer rail equity.

Many Louisiana utilities are vitally affected by the transportation rates for the movement of coal and therefore are supportive of legislation to provide adequate protection for the rates to be charged by the rail carriers.

We would appreciate your efforts to support enactment of such legislation.

Very truly yours,

LOUIS S. QUINN, *Secretary.*

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION,
Washington, DC, February 19, 1986.

Hon. RUSSELL B. LONG,
225 Senate Russell Office Building, Washington, DC.

DEAR SENATOR LONG: On behalf of the 25 million members served by systems belonging to the National Rural Electric Cooperative Association, I want to thank you for your support of the revised S. 477, the Consumer Rail Equity Act. NRECA supports the revised legislative language introduced in the Senate on October 31, 1985 as an amendment in the nature of a substitute. We feel this current language removes any doubt that the intention of the legislation is in any way an attempt to place the rail industry under unnecessary regulation.

In my capacity as the convener of the Consumers United for Rail Equity [CURE] Coalition, I have strived to preserve and promote rail freedoms where competitions exists. however, it is the belief of the coalition that where no free-market forces exist to preserve the competitive balance, it is the proper role of government to insure that monopoly tarrifs and anti-competitive actions are not the result. We feel that S. 477, as revised, accomplishes these goals.

NRECA and the CURE Coalition members look forward to participating in this important legislative endeavor.

Sincerely,

BOB BERGLAND, *Executive Vice President.*

CONSUMER FEDERATION OF AMERICA,
February 20, 1986.

Hon. RUSSELL LONG,
225 Senate Russell Office Building
Washington, DC.

DEAR SENATOR LONG: Having recently testified before the Committee about the problems in the Interstate Commerce Commissions implementation of the captive shipper provisions of the Staggers Rail Act of 1980, the Consumer Federation of America is writing to you to urge a swift mark-up and passage of the Consumer Rail Equity Act of 1985.

Passage of this Act will restore the balance that Congress intended to strike between the legitimate needs of some railroads for greater revenues and the equally legitimate needs of some shippers for protection from the abuse of railroad monopoly power.

The bill before the Committee preserves the fundamental principles of the Staggers Act.

Because it utilizes the same jurisdictional threshold, the bill accepts the principle of differential pricing, which is so important to the Staggers Act.

Because it leaves untouched the definition of the Long/Cannon factors, it accepts the Staggers Act's approach to the application of differential pricing.

Because it does not alter the mechanism for rate suspension, it eliminates regulatory lag, as the Staggers Act did.

Because it adopts the concept of allowing railroads to earn a reasonable rate of return, it embraces the commitment to an economically sound and safe rail network.

The bill imposes some reason on a regulatory agency that has neglected Congressional intent.

It forces the ICC to abandon its bizarre accounting procedures, which are utilized by virtually no other regulatory agency in the nation.

Instead of only allowing rates to rise with inflation, as current policy stipulates, it will also allow rates to fall as inflation declines.

Instead of permitting rates to be set only on the basis of theoretical costs, it will force the Commission to look at the actual costs of service in determining whether rates are reasonable.

As in most other regulatory proceedings, it requires the party seeking a rate increase to prove that rates are reasonable, but unlike other regulatory proceedings it will allow the railroads to collect those rates even before they are found reasonable.

The captive shipper provisions are of special importance to the nations' electric utility consumers. Costs for the acquisition of coal are passed through directly into consumers' bills, either through fuel adjustment clauses or as unchallengeable expenses. Coal is also the commodity over which the railroads have greatest monopoly power. Thus, the captive shipper protections of the Staggers Act are, in fact, the monopolized consumer protections of the Act.

The failure of the ICC to behave responsibly has created a gross and growing inequity. The sharp increase in coal transportation over the last decade has led to dramatically falling unit costs, but the railroads have used their market power to hold rates far above costs.

Although found "revenue inadequate" by the ICC, the stocks of the three leading coal hauling railroads are among the most highly regarded on Wall Street and in the past three years the Burlington Northern managed a $1.3 billion purchase of El Paso Gas Company; CSX found $1 billion to purchase Texas Gas Resources; and Norfolk Southern put $1.2 billion on the table to purchase Conrail.

These three companies, which earned almost $3.5 billion from their railroading operations since the Staggers Act, would have had to earn an additional $6 billion to have passed the ICC's revenue adequacy test. The ICC has lost all touch with reality. There is no relief in sight for captive shippers under such a regulatory regime.

The national transportation policy of the Staggers Act correctly requires utilities and consumers to pay for an efficient, safe rail network. But sound public policy does not require that these shippers and consumers be overcharged to fill a bottomless pit of fictitious revenue needs or to finance massive forays into other industries.

The balance that Congress intended can be restored by the careful refinements contained in the Consumer Rail Equity Act of 1985. We urge its swift passage.

MARK COOPER, *Energy Director.*

NATIONAL FARMERS UNION,
February 20, 1986.

Hon. RUSSELL B. LONG,
U.S. Senate, Senate Russell Office Bldg., Washington, DC.

DEAR SENATOR LONG: On behalf of the 300,000 farm and ranch families who are members of the National Farmers Union (NFU), we would like to thank you for the leadership role you have provided in support of S. 477, the Consumer Rail Equity Act. We want you to know that the National Farmers Union fully supports the revised version of S. 477.

Members of the NFU are not only farmers, they also are agricultural shippers. They depend on rail transportation for farm inputs and for movement of many of their agricultural products to market. Our members are deeply concerned over the ICC's misimplementation of the Staggers Rail Act which has allowed anti-competitive practices of certain rail carriers to go unchallenged. We believe it is time for Congress to take action to reinforce the intent and purpose of the Staggers Rail Act and to assure protections for shippers who are subject to railroad monopoly power.

We are pleased that the Surface Transportation Subcommittee is holding legislative hearings on S. 477 this week. We offer our continued and active support of your efforts to pass the Consumer Rail Equity Act.

Sincerely,

ROBERT J. MULLINS,
Director of Legislative Services.

National Coal Association,
February 20, 1986.

Hon. Russell B. Long,
U.S. Senate, 225 Senate Russell Office Building, Washington, DC.

Dear Senator Long: As you know, the National Coal Association supported the Staggers Rail Act of 1980 because we believed it was essential to the economic health of the railroad industry. Since 58.2% of coal shipped in the U.S. moves via rail, we continue to believe that railroads should be able to achieve an adequate rate of return on their investments as with any other industry.

Our support for the Act, however, hinged on the provisions which were designed to protect shippers in captive situations from potential rail rate abuses. Unfortunately, almost six years after enactment of the Staggers Act, we find that the Interstate Commerce Commission has failed to implement those provisions as Congress had intended.

Therefore, we unequivocally support the remedial amendments to the Staggers Act contained in S. 477, the "Consumer Rail Equity Act" sponsored by yourself and several of your colleagues on the Senate Commerce, Science and Transportation Committee. I wish to take this opportunity to express appreciation on behalf of the members of the national Coal Association for your leadership and efforts to secure Congressional support and action on this very important legislation.

Sincerely,

Carl E. Bagge, *President.*

Ethyl Corporation,
Logistics Department,
February 20, 1986.

Hon. Russell B. Long,
225 Russell Senate Office Building,
Washington, DC.

Dear Senator Long: As a major shipper of goods by rail, Ethyl Corporation would like to take this opportunity to commend you for your leadership and sponsorship of the Consumer Rail Equity Act. While we recognize and strongly support the need for a healthy, viable rail system, the absence of effective competition among railroads has at times left us defenseless against the exploitation and unbridled market power of the nation's six remaining major railroads.

In 1980, the Staggers Rail Act was enacted to free our railroads of unnecessary regulatory burdens allowing for more freedom in the marketplace. Since 1980, where rail-to-rail competition exists, deregulation has worked well for shippers and railroads alike.

Captive shippers have a different situation. The Interstate Commerce Commission has concentrated on that part of the Staggers Rail Act that calls for revenue adequacy of rail carriers and has ignored the part of Staggers that calls for continued rail-to-rail competition. The Congressional intent for balance between shipper and rail carrier needs has to this date not been implemented. Therefore, shippers have no recourse but to ask Congress to further clarify its intent. Your legislation does just that.

In searching for a solution to our problems concerning insufficient rail-to-rail competition, Ethyl joined the ProCompetitive Rail Steering Committee. This organization supports the goals of competitive access as stated in your bill. While we certainly understand the time constraints of the February 21 Surface Transportation Subcommittee hearing, the ProCompetitive Rail Steering Committee would like to be invited to present our views before the Committee in the future.

Ethyl Corporation has always believed that healthy railroads are vital to our nation's economy, but we also believe that healthy shippers are equally important to the nation's economy and that the enormous market power the railroads possess should not go unchecked.

Very truly yours,

M.A. Crane,
Director of Logistics.

AMERICAN BAKERS ASSOCIATION,
February 20, 1986.

Senator RUSSELL LONG,
225 Russell SOB,
Washington, DC.

DEAR SENATOR LONG: The American Bakers Association is pleased that the Senate Subcommittee on Surface Transportation has scheduled legislative hearings on S. 477, the Consumer Rail Equity Act. We want to assure you that the ABA continues to support S. 477 in its amended form.

The ABA represents over 400 bakers and allied suppliers located in every state and region of the country. We share with many Senators and Congressmen a growing concern over the misimplementation of the Staggers Act, and a recognition that Congress must act now to restore the purpose and intent of that Act as envisioned when it was passed.

On behalf of this country's baking industry, we would like to thank you for the excellent leadership, and outspoken support you have provided on this important issue.

Sincerely,

ROBERT J. WAGER, *President.*

NATIONAL GOVERNORS' ASSOCIATION,
February 21, 1986.

Hon. BOB PACKWOOD,
Chairman, Subcommittee on Surface Transportation, 508 Dirksen Senate Office Building, U.S. Senate, Washington, DC.

DEAR CHAIRMAN PACKWOOD: We are writing you on behalf of the National Governors' Association in support of Congressional action to ensure protection for captive coal and agricultural shippers against the Interstate Commerce Commission's (ICC) inappropriate use of stand alone costs and definition of market dominance. As noted in the attached policy, NGA supports the basic principles of deregulation embodied in the Staggers Rail Act and opposes other changes to the statute.

For several years, NGA has supported policy statements admonishing the ICC to correct the manner in which it is implementing the captive shipper provisions of the Staggers Rail Act of 1980. The Governors believe the failure of the ICC to properly define captive shipments and equitably implement the Coal Rate Guidelines has marred the otherwise sound implementation of the Staggers Act. Specifically, the Governors are troubled by the product and geographic competition test for determining whether a carrier has market dominance. We believe the Coal Rate Guidelines do not provide that essential balance between the needs of shippers and the railroads' need for an adequate rate of return intended by the Staggers Act. The Governors urged the ICC to take action on these issues before February 15, 1986. Dissatisfied with the ICC's performance in dealing with these specific problems, the Governors now feel that it is necessary for the Congress to act.

On the issue of product and geographic substitution or competition, the Governors are troubled by the ICC's overly restrictive interpretation of the law and believe that the application of this theoretical standard to coal and agricultural suppliers is unfair and inappropriate. With regard to product substitution, the negative effect on shippers and consumers of coal could be particularly severe if an electric utility plant were required to convert to other energy sources at prohibitive costs.

The Governors do acknowledge and applaud the recent decision of the ICC to adopt the agreement (Ex Parte No. 320) entered into by the Association of American Railroads and the American Paper Institute concerning market dominance determinations. This action places the burden of proving the existence or lack of product and geographic competition on the railroad, but does not eliminate consideration of these forms of competition as the Governors have sought. The Governors urge acton to clarify that a rail shipment is captive when an economical alternate means of transportation is unavailable.

On the Coal Rate Guidelines, the Governors believe the ICC has failed to provide the essential balance between the needs of carriers, captive shippers, and the public as intended by the Congress when enacting the Staggers Act. A major concern is that the "stand-alone cost" provision is an unfair test of rate reasonableness. Action by Congress is needed to rectify this situation.

The ICC recently was asked to respond to our concerns. The ICC's response to our request is attached for your information. We appreciate this opportunity to provide comments on the captive shipper issue and request you to make this letter and the attached policy statements a part of your hearing record on the implementation of the Staggers Act by the ICC.

Sincerely,

Governor **Anthony S. Earl**,
Chairman, Committee on Energy and Environment.
Governor **Robert D. Orr**,
Chairman, Committee on Transportation, Commerce and Communications.
Governor **Arch A. Moore, Jr.**,
Vice Chairman, Committee on Energy and Environment.
Governor **William A. O'Neill**,
Vice Chairman, Committee on Transportation, Commerce and Communications.

Attachments [1]

Association of American Railroads,
April 14, 1986.

Hon. **Bob Packwood**,
Chairman, Subcommittee on Surface Transportation, Committee on Commerce, Science and Transportation, U.S. Senate, Washington, DC.

Dear Mr. Chairman: On December 12 the Shippers National Freight Claim Council (SNFCC) submitted testimony on freight claim issues for inclusion in the record of the Staggers oversight hearings held by your Subcommittee. Because the testimony does not accurately portray issues with respect to liability for freight loss and damage in the railroad industry, I am offering this response for inclusion in the record.

At the outset I would note that the issues raised by SNFCC are not new. Many of them were addressed by comments the AAR submitted to the ICC in connection with its study of cargo liability in Ex Parte No. 403. The AAR's comments, which refute most of the arguments advanced by SNFCC, are attached.

The arguments to which I wish to address these further comments are those dealing with railroad-shipper relationships. In that regard, the fact of most importance is that the traffic around which SNFCC's complaints revolve is not traffic as to which the railroads exercise market dominance. To the contrary, it is traffic such as TOFC/COFC, boxcar, produce, and other traffic for which the railroads have to fight tooth and nail. It is the very type of traffic as to which the Congress, the Commission and, indeed, shippers have concluded that regulation is not necessary either as to rates or terms of service.

In taking issue with railroad contract provisions concerning full liability and released rates, deductibles, and time limits for filing claims (SNFCC testimony, pp. 3–9), SNFCC complains that railroads can offer released rates without prior ICC approval, that deductibles are not sound from a shipper's point of view, and that "short" time limits for filing claims are unfair to shippers. SNFCC overlooks the fact that railroads do not force shippers to agree to specific rates, deductibles, time limits for filing claims, etc. In the competitive marketplace that exists for TOFC/COFC and other traffic of concern to SNFCC, shippers can choose between various transportation modes and carriers within each mode and bargain for contracts that contain the best combination of rate, liability, and other terms of service. The decision by a railroad to offer, and by a shipper to take, a low transportation rate in exchange for a deductible or a shorter time limit for filing a claim is the result of negotiation, not duress.

TOFC/COFC traffic is extremely competitive and, consequently, the railroads 'profit margins on TOFC/COFC traffic are extremely small and the traffic is highly susceptible to diversion. In the case of fresh fruits and vegetables, the railroads have increased their market share from an almost negligible 10% of traffic in 1980 to a still paltry 13.3% in 1984. Clearly, shippers in these areas will go elsewhere if railroads do not offer acceptable terms. SNFCC admits as much. At page 13 of its testimony, it states: "In some instances, shippers have reported discontinuing the use of TOFC/COFC solely due to the unreasonable losses experienced with such services."

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[1] The attachments are in the Committee files.

With the marketplace ready to penalize railroads for offering unacceptable contract provisions, there is plainly no need for regulation or legislation.

Apparently, SNFCC believes that Congress should not let shippers decide between competing carriers, different rates and different liability provisions. That view is not representative of the shipping community as a whole. It is our experience that shippers prefer to have a choice of rates and conditions. In this connection, it is worth noting what the ICC stated in denying a petition of SNFCC in Ex Parte No. 230 (Sub. No. 5), the proceeding in which TOFC/COFC traffic was exempted from regulation. SNFCC petitioned for a declaratory order "to order the railroads to cease and desist from issuing contracts of carriage in violation of Section 11707 of title 49." The ICC stated:

Petitioner also alleges several problems with certain carrier circulars concerning liability for loss and damage. These allegations, however, are not sufficient to warrant any specific response on our part at this time . . . [R]educed liability on the part of the carrier may be entirely acceptable to shippers in the context of reduced rates. *Petitioner neither identified any individual shipper who is objecting nor complained in the context of specific rates.* To this extent, petitioner has presented, in effect, only examples of carrier offers [sic] limiting liability, which the carriers may pursue . . .

If concrete problems arise with respect to carrier loss and damage practices, we would, of course, accept petitions to amend in an appropriate manner the exemption given TOFC/COFC traffic. (46 Fed. Reg. 32257 (1981) (emphasis added)). Despite the ICC's invitation for petitions asserting that action is needed to correct problems arising out of railroad freight claim practices, to our knowledge no petitions have been submitted.

In summary, SNFCC's proposals do not make sense from either the shippers 'or the railroads 'perspective. Neither has anything to gain by arbitrarily limiting the conditions of service that can be negotiated. There are numerous trade-offs to be made and what is suitable to one shipper may not be to another. Where competition flourishes, as it does with respect to the traffic of concern to SNFCC, the parties involved and the public are best served by an unfettered freedom to negotiate.

Your acceptance of this letter for inclusion in the record will be appreciated.

Sincerely,

William H. Dempsey, *President.*

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